LIBRARY
SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
SEP 22 1970
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,

Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal of California, First Appellate District

Jurisdictional Statement

VALENTINE BROOKES
601 California Street
San Francisco, California 94108
Attorney for Appellant

BORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

SUBJECT INDEX

	Page
Opinions Below	2
Jurisdiction	2
Constitutional Provisions, Statutes and Regulations Involved	3
Questions Presented	3
Statement of the Case	5
A. Material Facts	5
B. Stage at Which Federal Questions Were Raised	11
Summary of Argument	12
The Federal Questions Are Substantial	16
Conclusion	39
Appendix A	App. 1
Appendix B	App. 12
Appendix C	App. 14
Appendix D	App. 23
Appendix E	App. 25
Appendix F	App. 29
Appendix G	App. 49
Appendix H	App. 51
Appendix I	App. 61

TABLE OF AUTHORITIES CITED

Cases	Pages
Airway Electric Appliance Corp. v. Day, 266 U.S. 71	17
Bolling v. Sharp, 347 U.S. 497	16, 38
Buther Brothers v. McColgan, 315 U.S. 501	17, 24
Cannon Mfg. Co. v. Cudahy Packing Co., 267 U.S. 333	15, 33, 34
Chas. C. Steward Mach. Co. v. Davis, 301 U.S. 548	38
Currin v. Wallace, 306 U.S. 1	38
Detroit Bank v. United States, 317 U.S. 329	16, 38
Edison California Stores v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947)	35
El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, 215 P. 2d 4	27
Fargo v. Hart, 193 U.S. 490	17, 24, 25
Frick v. Pennsylvania, 268 U.S. 473	17
F. W. Woolworth Co. v. Director, 45 N.J. 466, 213 A. 2d 1	35
Gulf Oil Corp. v. Clayton, 267 N.C. 15, 147 S.E. 2d 522 (1966)	25, 35
Hans Rees' Sons v. North Carolina, 283 U.S. 123	26, 27
Hoeper v. Tax Commission, 284 U.S. 206	37
Hudson Distributors v. Eli Lilly & Co., 377 U.S. 386	3
International Harvester Co. v. Evatt, 329 U.S. 416	13, 17, 27
Montgomery Ward & Co. Inc. v. Franchise Tax Bd., 6 Cal. App. 3d 149, 85 Cal. Rptr. 890	27
National Leather Co. v. Massachusetts, 277 U.S. 413	35, 36
Norfolk & Western Ry. Co. v. Missouri Tax Comm. 390 U.S. 317	3, 12, 13, 14, 17, 20, 25, 26, 27, 28, 29, 30
Pacific Co. v. Johnson, 285 U.S. 480	15, 34
Pullman's Palace-Car Co. v. Pennsylvania, 141 U.S. 18	17

Pages

Skelly Oil Co. v. Commissioner, 269 Minn. 351, 131 N.W. 2d 632 (1964) 25
Southern Ry. Co. v. Kentucky, 274 U.S. 76 ..... 17, 24, 36
Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 ..... 15, 34
Square D Co. v. Board of Tax Appeals, 415 S.W. 2d 594 (Ky. 1967) 25, 35
Studebaker Co. v. Gilchrist, 244 N.Y. 114, 155 N.E. 68 (1926) 15, 34
Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406, 34 Cal. Rptr. 545 (1963) 21

Wallace v. Hines, 253 U.S. 66 ..... 12, 13, 14, 17

Zale-Salem, Inc. v. State Tax Comm., 237 Ore. 261, 391 P. 2d 601 (1964) 32, 35

STATUTES

California Code of Civil Procedure, Section 401 2
California Revenue and Taxation Code:
Section 25101 ..... 3, 36
Section 25103 ..... 3, 35
Section 25104 ..... 3, 35
Section 25105 ..... 3, 30, 31
Section 26102 ..... 2, 3, 35
Federal Internal Revenue Code, Section 482 35
15 U.S.C. §§ 381-384 ..... 14, 33
28 U.S.C. § 1257(2) 3
Public Law 86-272 ..... 14, 15, 38

CONSTITUTION

United States Constitution, Art. I, § 8, Ch. 3 ..... 3, 16

TEXTS

H.R. Rep. No. 1480, 88th Cong., 2d Sess. at 245 (1964) 14, 32
SEC Regulations, 17 C.F.R. part 210 31

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. .....

CHASE BRASS AND COPPER CO., INCORPORATED,

Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal of California, First Appellate District

Jurisdictional Statement

This is an appeal from a state court decision holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with that of its parent, Kennecott Copper Corporation, and with that of Kennecott Sales Corporation and Kennecott Wire and Cable Co. Appellant submits this Statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, affirming in part and reversing in part a decision of the trial court, is reported at 7 Cal. App. 3d 99, 86 Cal. Rptr. 350, and is set forth in Appendix A. The opinion of the Court of Appeal on denial of petition for rehearing is reported at 10 Cal. App. 3d 496, 87 Cal. Rptr. 239, and is set forth in Appendix B. The California Supreme Court denied a hearing without opinion. The Superior Court for the State of California in and for the City and County of San Francisco, in giving judgment for appellant, filed no written opinion. Its finding of facts and conclusions of law are set forth in Appendix C.

JURISDICTION

This suit for refund of state corporate franchise taxes was brought pursuant to section 26102 of the California Revenue and Taxation Code and section 401 of the California Code of Civil Procedure. The California Superior Court in and for the City and County of San Francisco held that Chase Brass and Copper Co., Incorporated (Chase) was not unitary with any other corporation, should be taxed only by its own net income, and was therefore entitled to the claimed refund. This decision was reversed in part by the California Court of Appeal, First Appellate District. The final judgment of the Court of Appeal was entered on April 29, 1970. Opinion on Denial of Petition for Rehearing was filed on May 27, 1970. The Supreme Court of California denied Chase's timely Petition for Hearing on June 24, 1970, without rendering an opinion. A notice of appeal to this Court was filed in the Court of Appeal on July 10, 1970. A copy of that notice is set forth in Appendix D.

Jurisdiction to hear this appeal is conferred on this Court by 28 U.S.C. § 1257(2) and is supported by decisions in *Norfolk & Western Ry. Co. v. Missouri Tax Comm.* 390 U.S. 317; and *Hudson Distributors v. Eli Lilly & Co.*, 377 U.S. 386.[1]

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The Commerce Clause of the Constitution of the United States (Art. I, § 8, cl. 3) and the Due Process Clause of the Fourteenth Amendment are set forth in Appendix E.

The pertinent sections of the California Revenue and Taxation Code, sections 25101, 25102, 25103, 25104, and 25105, are set forth in Appendix E.

QUESTIONS PRESENTED

1. Can two commonly owned but separately incorporated and separately integrated businesses, only one of which does business in the taxing state, be treated by that state as unitary with each other and consolidated for formulary apportionment, without repugnancy to the Due Process and Commerce Clauses, where the sole basis for treating them as unitary with each other is minor common cost saving opportunities from which each corporation benefits, and common control of major policy, but the findings of fact are that the manner in which they operate does not cause either corporation to receive income actually earned by the other, and the widely differing margins of profit of the two types of business necessarily cause the averaging effect of the formula to shift immense amounts of income from the more profitable business to the less profitable one.

---

1. In the latter case (see 377 U.S. at 389, n. 4), collateral issues not finally resolved did not prevent this Court's review, and should not in this case. See Appendix H, pp. 51-60, where we develop the maximum favorable resolution of the taxpayer's case, and show even this to be unconstitutional.

2. If the answer to the first question would ordinarily be affirmative, is a state's consolidation of a parent and subsidiary corporation for purposes of the state's apportionment formula repugnant to the Due Process and Commerce Clauses, where only the subsidiary can be taxed because the parent does no business in the taxing state, and where the findings of fact are that the effect of the consolidated formula was "to assign to" the subsidiary "income earned by the income earning activities of" the parent, and the extent of the distortion produced by the consolidated formula is to multiply the subsidiary's income sevenfold.

3. Is it repugnant to the Due Process and Commerce Clauses for California to impose a privilege tax for the exercise of the corporate franchise on a foreign subsidiary corporation which does business within its borders, measured by the net income of the foreign parent corporation which the state stipulates did not do business within its borders, where each corporation operates an integrated business of its own, the transactions between them are governed by the standards of the market place, and there are no circumstances warranting the disregard of the corporate entity of either.

4. Is discrimination repugnant to the Due Process Clause present where California imposes a heavier tax burden on a foreign corporation operating an integrated business within and without the state, than it imposes on business competitors, merely because the foreign corporation is a subsidiary of another foreign corporation, and in the absence of intercorporate abuses and also in the absence of facts showing that the status of the taxed corporation as a subsidiary gives it economically measurable advantages over its independently owned competitors.

STATEMENT OF THE CASE

A. Material Facts.

The facts of this case were not fully stated in the opinion of the Court of Appeal, and are here supplemented by references to the Findings of Fact (Appendix C) and portions of the Stipulation of Facts (Appendix F).[2] The record below also included the uncontradicted testimony (See App. 5) reflected in part in the Findings.

Chase, a Connecticut corporation organized in 1909, manufactures brass, bronze, and copper rod, wire, sheet, and tube. Manufacturing is done in plants located in Connecticut and Ohio. Chase is qualified to do business and is doing business in 25 states, including California. In 1929, its stock was acquired and has been since owned by Kennecott Copper Corporation (Kennecott). (App. 29)

The parties stipulated:

> "[T]he President of Chase . . . directed the affairs of Chase. His time and attention were given to Chase; he was not responsible for the business operations of Kennecott or of any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale." (App. 34.)
>
> "[D]ay-to-day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day-to-day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various sub-ordinate employees of the subsidiaries. . . ."
> (App. 33)

---

2. Hereafter appendix references are to App., followed by the page number.

Both the president and executive vice president of Chase came to Chase from independent companies. (App. 41.)

The taxes at issue in this appeal involve the income years 1954, 1955 and 1956. They are upon Chase's privilege of exercising its franchise within California and are to be measured by Chase's net income derived from California. Rev. & Tax. Code § 23151.

Where a corporation's net income is derived from sources within and without the state, California requires apportionment to determine the income derived from sources within California. Rev. & Tax. Code § 25101. In its California tax return, Chase reported its entire net income as reflected on its books of account, and computed its California income on the basis of the traditional three-factor apportionment formula, which is the average of the ratios of property, payroll and sales within the state to those outside the state. (App. 2.) For neither state nor federal tax purposes did Chase or Kennecott, the parent, file consolidated returns. (App. 48.)

The Franchise Tax Board redetermined Chase's California income by consolidating its income with that of Kennecott, Kennecott Sales Corporation (Kennecott Sales), Kennecott Wire and Cable Co. (Kennecott Wire), Bear Creek Mining Co. (Bear Creek) and Braden Copper Co. (Braden). (App. 2.) The effect of this redetermination was to multiply both Chase's California income and its overall corporate income thirteen-fold. The Superior Court disapproved the consolidation and gave judgment for appellant. The Court of Appeal sustained the consolidation of Chase with Kennecott, Kennecott Sales and Kennecott Wire, but not with Braden and Bear Creek.

Kennecott, a New York corporation, mines, smelts and refines copper, gold, silver, and molybdenite. It does no

business in California. (App. 2.) Kennecott, through Kennecott Sales, sells fungible copper to numerous fabricators. (App. 44-45.) Approximately 20% of its total production of copper is sold to Chase and 4% to Kennecott Wire; the remaining 76% is sold to other customers. (App. 39.) Chase's two major competitors together purchased approximately as much of Kennecott's output of copper as Chase did, representing between 50% and 60% of their copper requirements. (App. 19.) Chase's purchases from Kennecott constituted approximately 80-84% of the copper purchased by it. (App. 3.)

Kennecott Sales, a New York corporation, took over in 1934 the sales activity theretofore assigned by Kennecott and Braden to an independent sales agency. No sales are made in California. (App. 3, 17, 37.) Kennecott Sales charges Kennecott a commission on each sale (App. 3), and sells the copper to Chase and others at the going market price for fungible refined copper (App. 10, 44). For the years at issue, Kennecott Sales paid to the State of New York a tax upon its entire corporate net income and New York did not allocate any part of that net income to other states. (App. 48.)

Kennecott Wire, a Rhode Island corporation, manufactures copper rod, wire and cable for transmission of electricity. Its stock was purchased by Kennecott from outsiders in 1935. It uses refined copper which it purchases from Kennecott Sales. Its sales operations in California are largely handled by Chase. Kennecott Wire did no business in California during the relevant years. (App. 3, 29-30, 32.) The president of Kennecott Wire was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete line and staff organization, which under his direction, carried out

the fabricating, pricing, selling (except as for that part handled by Chase), purchasing, record keeping, employee relations, and all other customary and necessary functions of a modern corporation engaged in fabricating and selling on a wide scale. (App. 34-35.) For the years at issue, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income and Rhode Island did not allocate any part of that net income to other states. (App. 48).[3]

The trial court, on the basis of evidence said by the Court of Appeal to be uncontradicted (App. 5), found as ultimate facts (App. 20):

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden, and Kennecott Sales . . . .
>
> "Chase's business activities are not so interrelated with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business con-

3. Braden, a Maine corporation, operated copper mines in Chile. Braden sold fire refined copper. It was a Western Hemisphere Trade Corporation for federal income tax purposes and ordinarily sold only to the Chilean government or on the world market. In the years at issue, due to United States copper shortages, it did sell, through Kennecott Sales, in this country. Chase was a buyer. (App. 2.)

Bear Creek, a Delaware corporation, explored for metals in California during the years at issue but made no significant discoveries. It is the third company in the mining group composed of Kennecott, Braden, and Bear Creek. (App. 2-3.)

The board included Braden and Bear Creek in the consolidation, but both courts excluded them. (App. 11.) The status of these two corporations is not now an issue.

tact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent market place.

"Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership."

It held that on these facts Chase was not unitary with any other corporation (App. 21-22), and rendered judgment for Chase. (App. 22.)

The Court of Appeal reversed the decision of the trial court in part, holding that the combined reporting of Chase, Kennecott Wire, Kennecott Sales and Kennecott was proper (App. 6-9), because:

1. Kennecott does "minor" purchasing of some supplies for Chase;

2. Although Chase maintains its own trade name, trademark, advertising program and budget, its advertisements often contain a statement that Chase is a subsidiary of Kennecott;

3. Although Chase and Kennecott keep separate books of account, the two use the same accounting firm (the court mistakenly said that they also file consolidated tax returns, though the stipulated fact (App. 48) is to the contrary);

4. Although Chase has its own legal staff and on occasion employs its own outside counsel, the presentation of the protest of Chase before the Franchise Tax Board in this case was handled by Kennecott employees (the Court of Appeal did not refer to testimony that the reason Kenne-

cott had its employees handle the protest was that it felt its income was being taxed (RT 54);

5. In 1955 Kennecott made a loan to Chase, in the amount of ten million dollars, for the rehabilitation of a plant severely damaged by flood, although the prime bank rate of interest was charged and the loan including interest was repaid within four years (the Court of Appeal did not refer to the fact that the effect of the flood was to close the plant for portions of two of the years involved here and to lower greatly Chase's margin of profit);

6. Although the pension plans for hourly employees were separate, Kennecott administers a common retirement plan for salaried employees;

7. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters;

8. Salaries above $15,000 for employees of Chase and Kennecott Wire were submitted to Kennecott's salary committee for review;

9. Chase warehoused and sold some of Kennecott Wire's production of wire mill products; and

10. Chase annually purchased about 20% of Kennecott's copper output, all of the purchases of which were at prevailing market prices.

The Court of Appeal concluded (App. 10-11):

> "The fact of the sales alone, however, whether especially advantageous to Kennecott or Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary."

The Court of Appeal held that Chase was not unitary with either Braden or Bear Creek, but was unitary with

Kennecott, Kennecott Sales and Kennecott Wire. It remanded the case to the trial court for the task of calculating the limited refund due under its decision. (App. 11.) Our calculations are that if all doubts are resolved in favor of the taxpayer, the additional income allocated to Chase on the consolidated basis will still be seven times that shown by its own records. (See footnote 8, p. 22, *infra*.)

B. Stage at Which Federal Questions Were Raised.

The federal questions presented here were raised by the pleadings in the trial court. The complaint alleged that the denial of the claim for refund was "erroneous, contrary to federal and California law, and unconstitutional under both the commerce clause and the due process clause of the United States Constitution. . . ." The trial court concluded that Chase was not engaged in a unitary business under California law and specifically did not reach Chase's constitutional claims. The issues not reached were enumerated in the trial court's Conclusions of Law (App. 21-22); all of them were raised in the briefs before the Court of Appeal.[4] The Court of Appeal, in reversing the judgment below in part, did not explicitly answer the arguments that the result it reached was repugnant to the federal Constitution. The Petition for Rehearing to the Court of Appeal requested the court to rule explicitly instead of tacitly on the issues arising under the Due Process and Commerce Clauses. In its opinion on denial of rehearing the Court

---

4. Chase's brief on appeal states in summation:

"In the preceding pages of our brief, we have demonstrated that appellant's actions have violated several federal constitutional principles. The one most flagrantly violated is the due process (Amendment XIV) and commerce clause (Art. I, section 8, co. 3) principle that a state must have some minimum connection with what it attempts to tax [citations omitted]." Respondent's Brief, p. 235.

again refused to answer the constitutional arguments. Chase's arguments under the Due Process and Commerce clauses were again raised in the Petition for Hearing in the California Supreme Court, which was denied.

SUMMARY OF ARGUMENT

1. California's franchise tax is subordinate to the federal constitutional principle that when levied on foreign corporations it may not be measured by values derived from other states. *Wallace v. Hines*, 253 U.S. 66; see also *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317. This Court has, as the foregoing cases demonstrate, permitted the use of an apportionment formula to allocate net income and other taxable values between states in which a unitary business operates, so long as the effect is not to tax substantial extraterritorial values which other states may more properly tax.

This case presents the question whether a foreign parent corporation not doing business within the taxing state is unitary, within the concept derived from this Court's decisions, with its foreign subsidiary which is doing business in the taxing state, where each corporation operates its own integrated business. Each of these businesses is unitary within itself, but they are not unitary with each other, for a number of reasons. As the trial court found, there are no transactions between them to blur the normal ability of an integrated business to ascertain its own corporate net income. The minor cost saving common functions produced savings from which each corporation benefitted and which each took into account in its own separate net income, but the California Court of Appeal found that these minor common functions plus common control of major policy made the two separate businesses unitary with each other. The California Court of Appeal believed, quite er-

roneously, that these minor consequences of common ownership justified shifting income between corporations and hence from outside California to within the state.

The California court ignored the facts before it which showed that the business California could not tax had a margin of profit more than ten times as great as that of the one it could tax, and also ignored the finding of fact of the trial court that that large margin of profit was earned exclusively by the nontaxable business and not by the out-of-state parent's imposing its will on the taxable subsidiary.

The necessary effect of what the California court did was to employ the unitary concept to combine two separate and distinct businesses which can readily determine their respective incomes, so as to shift income between them in a major shift not explainable by economics, and to impose a tax on income not possibly attributable to the taxing state.

The question whether this perversion of the unitary principle is repugnant to the Due Process Clause and the Commerce Clause is a substantial federal question.

2. Even in a single unitary business, an apportionment formula which does not achieve "rough approximation" is unconstitutional. *International Harvester Co. v. Evatt*, 329 U. S. 416; *Wallace v. Hines*, 253 U.S. 66; *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317. The California Court of Appeal ignored this principle and even refused to discuss it, although the record before it showed that the board's assessment method multiplied taxable values thirteen-fold over the actual values.

Even after correction for the removal of the errors in this assessment which the Court of Appeal agreed did exist, Chase's corporate net income was multiplied seven-fold beyond actual, by the magic of consolidation with its parent

and reallocation between them by a rigid formula. The formula assumes something contrary to the record, that the two businesses are equally profitable in ratio to property, payroll and sales. Where, as here, the respective margins of profit are inherently different, and a major plant of the less profitable corporation was closed for a substantial portion of two of the three years, a reallocation of net income between them by a rigid formula which assumes equal profitability can readily produce distortion, and here it did so by a seven-fold multiplication of actual corporate income.

A seven-fold multiplication is not any sort of approximation, rough or otherwise. It is blatant taxation of immense extraterritorial values. Even a business as traditionally unitary as the railroad business cannot be taxed by the unitary formulary method where such a result follows from it. *Wallace v. Hines; supra, Norfolk & Western Ry. Co. v. Missouri Tax Comm.; supra.* The refusal of the California Court of Appeal to observe this limitation is contrary to those decisions of this Court and therefore presents a substantial federal question.

3. A congressional committee has reported that California insists on litigating its right to require what it calls a combined report, and that that insistence may bring California into headlong conflict with Public Law 86-272 (15 U.S.C. §§ 381-384). (H.R. Rep. No. 1480, 88th Cong., 2d Sess. 245 (1964).) Under that act, California cannot tax Kennecott, Kennecott Sales or Kennecott Wire, because none of them has either property or employees in California. Nor can California tax them consistently with the Due Process Clause.

California does not claim it can tax them. What it claims is that it can circumvent its lack of jurisdiction to tax them by the guise of attributing ownership of their net income to Chase and taxing it there.

The question whether lack of jurisdiction can be thus circumvented is a substantial federal question under the Due Process Clause, and, because of its effect on the regulation of commerce adopted in Public Law 86-272, under the Commerce Clause as well.

4. The tax involved is a corporate franchise tax measured by net income, not a tax on the net income itself. In sustaining California's right to measure this tax by tax-exempt interest, this Court has said that the distinction is "one of substance, not of form". *Pacific Co. v. Johnson,* 285 U.S. 480, 490. The reality of the distinction was again emphasized in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602. Yet here California is seeking to measure its franchise tax by values belonging not to this franchise but to other franchises not within California's jurisdiction to tax.

No claim is made that the corporations so conducted themselves that they disregarded their own corporate separateness, and the facts found, and those discussed in the opinion below, would negate such claim.

Nor is Chase's franchise enriched by what its parent owns.

This Court has held that when Congress confers or limits jurisdiction it does not mean to authorize disregard of corporate entities where the corporations themselves have not done so. *Cannon Mfg. Co. v. Cudahy Packing Co.,* 267 U.S. 333. Public Law 86-272, referred to above, should be so construed.

The leading case in the franchise tax field is *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). It supports our views. It did not reach this Court, but it is a particularly persuasive authority because the author of the opinion later became a member of this Court.

A substantial federal question is presented, accordingly, about the constitutional right of states taxing multi-state businesses in a manner to tax corporate franchises and simultaneously ignore them.

5. The Due Process Clause prohibits discrimination. *Bolling v. Sharp*, 347 U.S. 497; *Detroit Bank v. United States*, 317 U.S. 329. The prohibited discrimination here is taxing a subsidiary more heavily than its independently owned competitors.

Undoubtedly a subsidiary may enjoy benefits from its subsidiary status denied to its independent competitors, but none are shown to exist in the record here. On the contrary, the trial court found that in its dealings with Chase the parent treated Chase and its independent competitors alike.

The record identifies some of Chase's competitors, so we are not left to speculation about their existence, or the discrimination in their favor California's tax involves. The speculation this case invites is the existence of any economic justification for that discrimination. No such justification appears.

The decision below thus raises a substantial question about the validity of the discrimination against Chase and in favor of its independent competitors under the Due Process Clause.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

The federal questions arise under the Due Process Clause (Amendment XIV) and the Commerce Clause (Art. I, Sec. 8, Cl. 3). Although these federal questions constituted our major premise below, no reference is made in the opinion of the Court of Appeal either to them or to the decisions of this Court interpreting and applying them. In denying our petition for rehearing, the court finally responded to our insistence that decisions of this Court con-

trolled the issues presented by referring to one of them (*Norfolk & Western Ry. Co. v. Missouri State Tax Comm.*, 390 U.S. 317) as irrelevant. Other than this reference, nothing in the opinion suggests that California is not an independent nation, free to adopt its own standards of taxation without subordination to principles of the federal Constitution.

Yet this Court has declared the existence of federal constitutional principles to which California and the other states must yield. The California tax is a corporate franchise tax, and this Court has held repeatedly that a corporate franchise tax is repugnant to the Commerce and Due Process Clauses as applied to a foreign corporation such as Chase if measured by extraterritorial values. *Wallace v. Hines*, 253 U.S. 66; *Airway Electric Appliance Corp. v. Day*, 266 U.S. 71; *Southern Ry. Co. v. Kentucky*, 274 U.S. 76; *Butler Brothers v. McColgan*, 315 U.S. 501, 506-507, (cited below only by its state citation); *International Harvester Co. v. Evatt*, 329 U.S. 416. The same rule applies to other excise or privilege taxes (*Frick v. Pennsylvania*, 268 U.S. 473), to capital stock taxes (*Pullman's Palace-Car Co. v. Pennsylvania*, 141 U.S. 18), and to property taxes (*Fargo v. Hart*, 193 U.S. 490, and *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317). The propriety of measuring the tax by extraterritorial values is the federal issue presented but not considered by the Court of Appeal.

Because the decision below conflicts with applicable decisions of this Court, the federal questions are substantial.

I. A. This Court has never held two integrated businesses such as are presented here to be unitary with each other, and it should not tolerate such a decision. Chase conducts a multi-state integrated business in competition with others, all of whom, like Chase, buy refined copper from Kennecott. Chase buys from 80 to 84 percent of its

copper requirements from Kennecott (App. 3), but its competitors buy as much as 70 percent from the same source. (App. 18-19.) Chase and its competitors buy at the same price and on the same terms and when copper supplies are short subject to the same allocation of copper by Kennecott. Chase and its competitors buy other metals, none of which come from Kennecott, to alloy with copper, thus producing bronze and brass. From these alloys are fabricated the products they sell. (App. 3, 10, 32.)

Kennecott does not own the plants or sales facilities Chase uses. Chase owns them. What Kennecott does is to own vast mines and reduction facilities, all outside California, from which it produces its own end product, refined copper. This refined copper it sells to all its customers, only one of which is Chase, at the same price and on the same conditions. While Chase's purchases amounted to 20 percent of Kennecott's output, ten customers bought most of its output and a large number of smaller customers bought a total of only about 25 percent of it. (App. 44-45.) Hence large purchases by single customers are a characteristic of Kennecott's business. Thus Revere Copper & Brass Company, a competitor of Chase, was also a large Kennecott customer and bought in excess of 50 percent of its copper requirements from Kennecott. Together with General Cable it bought as much copper from Kennecott as Chase did, although the largest single shareholder of both Revere and General Cable was American Smelting and Refining Company (Asarco), itself a copper producer. (App. 25)

In the years involved, copper was in short supply and was allocated by the producers among their customers. To augment the supply, the United States suspended the import duty, thus admitting competitive foreign copper for fabricators to buy.

The two businesses were operated separately, each by one corporation. Chase had two factories, one in Connecticut and one in Ohio, and its staff and executives were there. (App. 29.) Kennecott's principal office is in New York (App. 29), and its mines and reduction facilities are in Utah, Arizona, Nevada and New Mexico (App. 31). Chase does business in California, whereas Kennecott does not. (App. 2-3) Chase had a complete line and staff organization headed by a president, which ran its business and had no role in Kennecott's business. (App. 34.) It had its own board of directors of eight members, five of whom were Chase officers employed in Connecticut. Three members were Kennecott officials, and none of them attended a Chase meeting in the years involved. Similarly Kennecott had its own organization, to which Chase did not contribute any of its personnel. (App. 33-34.)

Chase and other fabricators characteristically have much smaller margins of profit than the mining companies (App. 61-63), and this disparity prevailed between Chase and Kennecott. The latter had one of the copper mining industry's highest margins of net profits to sales (45.4%), whereas Chase was hobbled by a strike and a flood and managed only a 2% margin. To combine the two and apportion between them by a common formula obviously has the effect of shifting profits from Kennecott to Chase.[5] Since Kennecott's property and business are entirely outside California, this procedure necessarily allocates income from other states, which have the right to tax it, into California for a second tax.

---

5. Implicit in the mathematics of an apportionment formula is the assumption that all property, payroll and sales in the apportionment unit will be equally productive of net income. Therefore when the two businesses combined into a single apportionment unit are greatly different in profit margins, the necessary effect is to average, which means to take from one and allocate to the other.

The foregoing is a necessarily truncated statement of the facts which led the trial court to find as facts that the formula shifted income to Chase from other corporations which had earned it, and that the relationship between Chase and Kennecott did not permit either to profit from the other in any way not fully reflected in their books of account. (App. 20.)

What the California Court of Appeal has held is, therefore, that the net income of two corporations each conducting its own integrated business, but only one doing so in California, and each with a corporate net income reflected in its books, must be consolidated and then apportioned back to each corporation by formula, because under California concepts they are unitary with each other. A reading of the opinion will show that the unitary aspects relied on are minor and more concerned with the existence of power than with its actual exercise.

The concept of a unitary business was borne of an effort to permit a state to tax the full value of the property and operations of a multi-state enterprise within its borders. A limitation this Court has enforced (see *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317, the latest relevant decision from this Court where the earlier ones are collected) is that the formula may not appropriate to the taxing state substantial values derived from and taxable by other states.

The present case is the first one presented to this Court in which a state has combined two corporations each with its own complete, integrated business, and has reallocated their income between them by formula and then apportioned the income thus artificially assigned to the only one doing business in the taxing state.[6]

---

6. California does this by a simplified mathematical process which is the mathematical equivalent. See App. 51-60 where we demonstrate how the California mathematics works.

In prior decisions sustaining a formula's use, geographical allocation of the income or property of a single integrated business was presented.[7] That is not the issue here; Chase filed its returns on that basis, for it employed the administratively devised three-factor formula and apportioned some of its corporate net income to California by that means. The board combined Chase's net income with that of its parent Kennecott, its sister Kennecott Wire, and its sisters Braden and Bear Creek. The trial court disapproved the entire consolidation, on findings of fact that it produced distortion (App. 20), but the Court of Appeal, while not denying the existence of the distortion found as a fact, reinstated the consolidation as to Chase, Kennecott and Kennecott Wire, finding them unitary as a matter of law.

We need not concern ourselves at this point with the facts about Kennecott Wire, which like Kennecott did no business in California. It is the allocation of Kennecott's huge income to Chase which produces the bulk of the distortion and which is vividly unconstitutional. The results of the Court of Appeal's legal conclusion of unity between these two separate businesses are to multiply Chase's net income seven-fold, and to confer on it the capacity to earn 46.7% as much income as Kennecott because it buys 20% of Kennecott's output and is owned by Kennecott,

---

7. The California conception of "a unitary business" which requires formulary allocation (apportionment) for geographical allocation of net income has been criticized. Hellerstein, "Recent Developments in State Tax Apportionment," 21 Nat.Tax J. 487, 497-503 (1968); and compare Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings L.J. 42, expressing the same thoughts as Professor Hellerstein, written prior to the decision in *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 34 Cal. Rptr. 545 (1963), which Professor Hellerstein criticized.

whereas due to flood and strike it actually earned 4.45% as much.[8]

The indicia of unity the Court of Appeal found are minor and in some instances pure speculation. They cannot possibly account for or justify a seven-fold increase in the profits of the less successful unit in the combination.

The court agreed that the opportunities for unity in a vertically integrated enterprise are few but after concluding that it was dealing with such "an enterprise" magnified all it could find. The court dwelt on the stipulation that Kennecott did some "minor" purchasing for Chase, and that in some instances some common insurance coverage was obtained.[9] While recognizing that Chase had its own trademark, advertising program and budget, the court observed that Chase's advertisements "often contain a statement that Chase is a subsidiary of Kennecott", and that when Chase

---

8. If every mathematical issue left for resolution on remand is decided in Chase's favor, the shifting of income between corporations accomplished by the Court of Appeal will be as follows (the schedule below summarizes the three-year cumulative income shifting detailed at App. 56-60):

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total	(3) Net Income Per Board's Formula	(4) Percentage Per Board's Formula	(5) Column 3 as Percent of Column 1
Chase	$ 11,597,596	4.12%	$ 88,269,277	31.36126%	761%
Kennecott Wire	8,979,615	3.19	3,897,805	1.38485	43
Kennecott	260,413,229	92.52	189,292,562	67.25389	73
Kennecott Sales	469,204	0.17	(entirely eliminated)	—	—
Total	$281,459,644	100.00%	$281,459,644	100.000 %	

9. The court conceded that "There was no intercompany coverage on basic industrial policies such as fire, fire use and occupancy, workmen's compensation, public liability, automobile liability and fire, sickness and accident, hospitalization and surgical, and certain types of bonds." Seemingly the court thought it unimportant that in major insured areas there was no intercompany coverage, but actually that is far more significant than the minor common coverage.

uses an agency it uses the same one Kennecott uses. The court even observed that both use the same accounting firm. It commented that Kennecott employees handled Chase's administrative protest in this case, without observing that Kennecott's assistant controller testified that that occurred because it was Kennecott's income by which the agency was attempting to tax Chase. (R.T. 54.) The ultimate was reached when the court referred to Kennecott's loan to Chase at the prime bank rate of interest, made to enable Chase to rebuild its flood-damaged plant, as "substantial evidence of unity of operation" because it was "advantageous to the over-all management." If everything "advantageous" justifies a consolidation of two separate, integrated businesses and a multiplication of the income of the only one the state can tax, then mere investment in a minority position in another corporation would justify consolidation, because the investment would not have been made had it not been advantageous.

As an obvious anti-climax, the court referred to the common retirement plan for salaried employees, without observing any irony in its treatment of two businesses as unitary with each other because of the fact that when employees cease to work in either they receive the same retirement benefits.

These were the indicia of unity of operation the Court of Appeal found. All are minor and are vastly outweighed by the dominant instances of separate operation. None can shift income or expense from one to the other, although some can minimize expenses, a benefit both shared. The critical question, though, since the combined formula shifts income, is whether it compensates for some tendency in the facts deemed unitary to shift income or expense. Containing no such tendency, those facts do not justify what was done by the court.

The same is true of the matters the court labelled "unity of use." The president of Chase "reported to the president of Kennecott with respect to major policy matters." The Court of Appeal said that " 'major policy matters' are what count. . . ."[10] Later after stating that Kennecott's sales of copper to Chase do "not determine the business to be unitary," the court reiterated that all the minor circumstances reviewed above, "and particularly those relating to control of major policy, together with the subject of sales", make Kennecott and Chase unitary.[11]

No major policy is suggested which could have shifted income or expense between Kennecott and Chase. Nor does the Court of Appeal suggest this was done. The absence of that relevant fact destroys any possible justification for what California has done.

The power to control major policy is a consequence of ownership. It is always where ownership is. Heretofore formulary allocation has been denied on constitutional grounds when common ownership was all that was present. *Fargo v. Hart*, 193 U.S. 490; *Southern Ry. Co. v. Kentucky*, 274 U.S. 76; and cf *Butler Bros. v. McColgan*, 315 U.S. 501, 509, where this Court noted, in sustaining the application of the California formula to a unitary business, that "no showing has been made that income unconnected with the unitary business has been used in the formula."

Common ownership does not convert unconnected properties to unitary status, the foregoing cases hold, and that

---

10. The court also found significance in Kennecott's prerogative of reviewing all Chase salaries about $15,000. This, a normal control of a board of directors, is an indicia of Kennecott's ownership of Chase, but nothing more.

11. The court's conviction that sales alone are not enough to make two businesses unitary is emphasized by its agreement that Braden and Chase are not unitary, although Braden was the source of some Chase copper.

is all there could be here. To tax Chase on Kennecott's income, which Kennecott earned in its own business, is at least as offensive to the Due Process and Commerce Clauses as apportioning income from investments unrelated to the unitary business, and this is not permissible. *Fargo v. Hart, supra.*[12]

The federal question is substantial and has not heretofore been presented by the action of any state.[13] If tolerated the California technique can be expected to be employed by other states, with resultant multiple taxation burdening commerce, and burdensome taxation of income not earned in the taxing state.

II. A. In paying its fleeting respects to the only case from this Court to which it referred (*Norfolk & Western Ry. v. Missouri Tax Comm.*, 390 U.S. 317), the Court of Appeal distinguished it on grounds which will not withstand analysis. The Court of Appeal dismissed it as presenting a narrow factual issue, and further as being "far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted." (App. 12-13.)

It is obvious that this Court did not review the *Norfolk & Western* case in order to settle a narrow factual dispute.

---

12. A quixotic element in this case is that there are real unitary aspects in the relationship between Kennecott and Asarco. Asarco smelted Kennecott's ore from its Arizona and Utah mines, and refined the smelter product from its Nevada mine and at times from its Utah and Arizona mines as well. But Asarco and Kennecott are entirely separately owned, so California recognized that they were able to distinguish the net income of each from the other, and that the consolidation-formula technique need not be applied to them in order to determine Asarco's net income from California. (App. 45-47.)

13. The other states which have considered comparable cases have held to the contrary. *Skelly Oil Co. v. Commissioner*, 269 Minn. 351, 131 N.W. 2d 632 (1964); *Square D Co. v. Board of Tax Appeals*, 415 S.W. 2d 594 (Ky. 1967); *Gulf Oil Corp. v. Clayton*, 267 N.C. 15, 147 S.E. 2d 522 (1966).

It is only slightly less obvious that the interstate railroad business involved in that case was a unitary business, since interstate railroads are the prototype unitary business to which less clear cases are analogized. It follows that if the Court of Appeal is correct, contrary to what we urge above, that Chase and Kennecott combine together to conduct a single unitary business, then the *Norfolk & Western* case has a message this Court intended be applied to it.

The *Norfolk & Western* case did two things. First it restated a doctrine long ago established: that even in the instance of a unitary business a formula which is normally reasonable is subject to attack on constitutional grounds where on the facts of a particular case it seriously overstates the values within the taxing state. This Court cited *Wallace v. Hines*, 253 U.S. 66, where a state franchise tax applied to an interstate railroad was held invalid because its apportionment formula failed to take into account substantial differences in local conditions from those in other states. There Mr. Justice Holmes had said for the Court (253 U.S. 66, 69):

> "The purpose is not to expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the State."

Not since 1931 had this Court reminded the states that that principle is still viable. *Hans Rees' Sons v. North Carolina*, 283 U.S. 123. It was restated and enforced in 1968 in *Norfolk & Western*.

Second, this Court announced a corollary principle. It held that a generalized assumption of enhancement of values due to unitary operation would not save a formula where the taxpayer produced evidence tending to show the formula allocated to the taxing state substantial values derived from other states, and therefore where such evidence

was produced the state must rebut it by evidence supporting the values produced by the formulary apportionment.

The opinions below show that both messages have been lost on the California Court of Appeal and its Supreme Court. The Court of Appeal held that the two businesses together formed one unitary business and therefore the formula must be used. Of the issue raised by the *Norfolk & Western* case, the *Hans Rees* case before it, and before it *Wallace v. Hines,* and other cases, it said nothing. Not a hint is in the opinion that there was evidence before the court that the effect of the formula was to multiply the California values at least seven-fold. Nor is there any reference to the evidence of source of income and of earning power, which evidence led the trial court to find as a fact (App. 20):

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden and Kennecott Sales..."

A seven-fold increase in Chase's corporate net income by formulary allocation produces a seven-fold increase in that allocated to California by the same formula. By contrast, the multiplication of taxable values this Court found objectionable in *Norfolk & Western* was only two to one. The California courts are inclined to quote this Court's language in *International Harvester Co. v. Evatt,* 329 U.S. 416[14] that "rough approximation is sufficient," whenever faced with evidence that a formula has distorted, but a seven-fold multiplication of taxable values is not any sort of approximation. It is an unconstitutional seizure of vast values

---

14. *El Dorado Oil Works v. McColgan,* 34 Cal. 2d 731, 215 P. 2d4 is the first such instance, and *Montgomery Ward & Co. Inc. v. Franchise Tax Bd.,* 6 Cal. App. 3d 149, 85 Cal. Rptr. 890 (on appeal to this Court, No. 592, Oct. Term 1970), the latest out of 7 citations.

earned in and taxable by other states. If a two-fold multiplication is invalid, as this Court held in *Norfolk & Western*, then a seven-fold multiplication is *a fortiori*.

The California court here did not claim that the result was "rough approximation." It did not even refer to the existence of evidence of distortion, or the finding of the trial court to that effect. It considered them legally irrelevant, in spite of *Norfolk & Western*. It said there were some indicia of unitary character and a formula therefore must be used, and in denying the rehearing it also declined to mention the evidence before it, although distinguishing *Norfolk & Western* on the ground that there was evidence of distortion in that case. The distinction offered is unconvincing. It really amounts to saying that a case stating the rules Missouri must follow contains no lessons for California.

Yet the court had before it both the findings of fact of the trial court, and the evidence relied on below which even the Court of Appeal acknowledged to be uncontradicted (App. 5), which showed that Chase could not possibly have earned more than the net income its books showed. In the Appendix (pp. 56-60) we reproduce tables showing in detail how the board's method multiplies Chase's corporate net income seven-fold. We have summarized them above in footnote 8 (p. 22).

It is evident, we submit, that what this Court meant to accomplish in the *Norfolk & Western* case has not been attained and must be restated if this Court intends that California observe it. The question deemed substantial there is even more so here, where the distortion resulting from blind adherence to the formulary apportionment is seven-fold instead of two-fold as it was there.

B. In denying the petition for rehearing, the Court of Appeal made a statement which comes closer to referring

to the evidence of distortion which was before it than anything else it said. It said of this Court's *Norfolk & Western* decision (App. 13):

> "The case is far removed from the present one, wherein the operations of the corporations are unitary, and separate accounting is not permitted."

Since the court rejected the controlling effect of the evidence of distortion which had led the trial court to find that the formula did distort, and since no other explanation is offered, the foregoing statement may contain the explanation. If so, the explanation is erroneous and misconceives both *Norfolk & Western* and the nature of acceptable evidence to prove distortion. Since the refusal to consider evidence showing distortion produces an unconstitutional result, a substantial federal question is presented.

The Court of Appeal's statement is wrong in every relevant respect. First, *Norfolk & Western* involved a railroad operating an archetypical unitary business, and the Court of Appeal thought, erroneously, that the two businesses before it involved a single unitary business. Therefore that asserted distinction does not exist.

Second, under the Missouri statute separate accounting was not permitted, and a particular apportionment formula was mandatory. If, as the Court of Appeal appeared to say, the California statute also made use of an apportionment formula mandatory, then the two statutes were identical in substance and not distinguishable.

Third, no one in this case is asking for the use of separate accounting as a geographical allocation device. We used the standard three factor formula in our returns, not separate accounting. What Chase objects to is having the formula applied to the income of other corporations and having a tax so computed assessed to Chase.

But in the state courts, the California Attorney General consistently referred to the evidence in the case as "separate accounting". While we equally consistently corrected him, the Court of Appeal may have used the term in that sense. If it did, then it meant to hold that all evidence of distortion is separate accounting and objectionable. This was the actual effect of its decision, so it may have meant, by this veiled ambiguity, to describe what it actually did.

The evidence this Court found convincing in *Norfolk & Western* was separate accounting in the same sense. The Court of Appeal had this fact before it in our briefs.

Since there was no unfair dealing or other improper shifting of net income between the corporations, the court must have meant to hold that as a matter of law a subsidiary cannot accurately distinguish its net income from that of its parent.[15] This may be California law but it is factual nonsense. Where, as here, a subsidiary operates an integrated business and its only connection to its parent is buying its raw material from the parent at prevailing market prices, minor cost saving steps which are reflected in lower costs for both, and subordination to its parent's power on major policy matters, the separate net income of the subsidiary can be determined.

It is done by the accounting profession regularly for scores of subsidiaries which have to report to minority shareholders, and their statements are certified by the profession.[16]

It is required by the federal Securities and Exchange Commission as a condition to registration of the subsidiary's

---

15. The California statute defines a subsidiary for this purpose as a corporation more than 50% of the stock of which is owned by another corporation. Rev. & Tax. Code § 25105.

16. Indeed, Chase's accountants certified its annual report for each year in issue. The text of the certification is in Appendix G (App. 49-51).

stock for trading.[17] Where the ownership by the parent is less than 80% and more than 50%,[18] certification by the independent accountants of the subsidiary's net earnings, assets and liabilities is required as a condition to registration of the parent's stock for trading. (SEC Regulations, 17 C.F.R. part 210.)

It is required by the federal Internal Revenue Code and regulations where consolidated returns are not filed. They cannot be where the parent owns less than 80% of the voting stock and need not be where it owns more.

With such common, frequent occasion to determine the corporate net incomes of subsidiary corporations for use by the public, stock exchanges and federal agencies, the techniques for doing so have been sharpened by practice and public and official scrutiny. To dismiss such a determination as non-evidentiary is arbitrary, and since such dismissal means that there cannot be credible evidence of a fact in issue under the Due Process and Commerce Clauses it also means that there is no way of vindicating a constitutional right.

Yet the position that all evidence of distortion is separate accounting was urged by the California Attorney General in the California courts. He was not deterred by his lack of success in the trial court. Like the Bellman who insisted that anything he said three times is true,[19] he said it again and again, and in the Court of Appeal it was accepted as true.

---

17. Thus, Aerojet General Corporation is more than 80% owned by General Tire and Rubber Co. and its minority shares are listed and traded on the American Stock Exchange. Many Bell System subsidiaries, more than 80% owned by American Telephone, list their minority shares on the New York Stock Exchange, where they are actively traded; viz, Pacific Telephone and Mid-Continent Telephone.

18. A distinction California's statute does not make. Rev. & Tax. Code § 25105.

19. Carroll, The Hunting of the Snark, Fit. 1, The Landing.

But it is not true, and its acceptance as if it were has the effect of denying appellant and other California taxpayers their constitutional rights.

III. This case is a test case, testing California's asserted right to require combined income reporting of affiliated corporations regardless of the facts. A congressional committee which studied state taxing practices at length reported (H.R. Rep. No. 1480, 88th Cong., 2d Sess. at 245 (1964):

> "[T]he term "combined report" is used to describe a report in which the taxable corporation's net income is combined with the net income of a nontaxable out-of-State corporation. . . . The combined income is then apportioned to the taxing State. Of the two corporations, only the in-State corporation is technically liable for the tax.
>
> "Under the combined report concept, a number of problems can arise. First of all, the concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. This may arise as a constitutional question or in terms of the limitations on State taxing power imposed by Public Law 86-272. In the latter case, the question is whether a State may require a company within its taxing jurisdiction to include in the measure of its tax income from an affiliate which is covered by an exemption in that statute. This question is unsettled, and as a result at least one State, California—the leading exponent of the combined report concept—anticipates that it will have to litigate the issues involved."

The litigation California anticipated is here, in this case. If California can succeed here, it may be assumed that other states may follow suit. So far, only in Oregon has a similar effort succeeded.[20]

---

20. *Zale-Salem, Inc. v. State Tax Comm.*, 237 Ore. 261, 391 P. 2d 601 (1964).

Congress gives no indication of providing an early end to this dispute over constitutional power. No bill has become law since that 1964 report, and the one which passed the House, to die in the Senate, provided no tests for the propriety of combined reports. Nor does the Uniform Allocation of Income Act, now adopted in more than half the states, do so. Presumably the reason for all this legislative silence is that the problem is generally recognized as a constitutional one arising under both the Due Process and Commerce Clauses, on which this Court's views must be heard, since they may be dispositive.

Congress has, however, enacted one statute, which California's technique here would circumvent. This is Public Law 86-272 (15 U.S.C. §§ 381-384), adopted in 1959, before the tax assessment in issue here. It prevents California's taxing Kennecott, Kennecott Sales and Kennecott Wire directly, a jurisdiction California denies it is asserting here anyway. California seeks to circumvent lack of jurisdiction, whatever its source, by allocating the income of a corporation it cannot tax to a corporation it can tax, and taxing it there.

If California is successful here, Public Law 86-272 will be readily circumvented by that state and all others adopting the California technique where affiliated corporations are involved.[21]

The decision here will, accordingly, if permitted to stand, have national consequences in undermining the effect of Public Law 86-272, as well as in sanctioning the circumvention of heretofore well established constitutional limitations on jurisdiction to tax. Thus it presents a substantial federal question.

---

21. Normally when Congress confers or limits jurisdiction over corporations, it does not mean to authorize disregard of the corporate entity except in instances where the corporations themselves have done so. *Cannon Mfg. v. Cudahy Packing Co.*, 267 U.S. 333.

IV. This is a corporate franchise tax, not an income tax, a distinction this Court has said is "one of substance, not of form" (*Pacific Co. v. Johnson,* 285 U.S. 480, 490). In so stating, this Court sustained California's right to include tax exempt interest in the measure of the tax, because that income contributed to the value of what was taxed and hence was a rational element in measuring its value.

The reality of the distinction between taxing net income directly and taxing the privilege of exercising a corporate franchise was underscored again in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, where this Court struck down a tax on the privilege of doing interstate business, measured by net income. A direct tax on income, fairly apportioned, would have been permissible.

Kennecott's income is not a rational measure of the value of Chase's franchise. Chase does not own Kennecott, and is not enriched by Kennecott's income. The question whether, absent abuses not even suggested to be present here, Chase may be compelled to pay a tax to California for doing its business there, measured not by its own income but by its parent's, is a substantial and undecided one, involving Due Process and Commerce Clause questions.

The leading case, written by a judge who later became a distinguished member of this Court, is *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). It held that a franchise tax on a subsidiary cannot be measured by its parent's income, unless the facts warrant the disregard of the corporate entity. California has never suggested that there are such facts here, and it even stipulated that Kennecott does not do business in California. (App. 2, 29.)

One could say with more conviction that the measure of value of a parent's franchise could include the subsidiary's income, since the parent owns the subsidiary and

the reverse is not true.[22] Even here, though, the state courts which have passed on the issue have usually refused to permit the consolidation of parent and subsidiary and the application of a combined formula to the total. *Square D Co. v. Board of Tax Appeals,* 415 S.W. 2d 594 (Ky. 1967); *Gulf Oil Corp. v. Clayton,* 267 N.C. 15, 147 S.E. 2d 522 (1966). Those courts have required evidence of abuse to justify the disregard of the corporate entity.[23]

California thus stands nearly alone among the states.[24] Its decision is the more remarkable because it is unnecessary to protect the state's valid interests. California has three statutory sections[25] modelled after section 482 of the federal Internal Revenue Code which allow it to shift income and deductions between affiliated corporations in instances of distorting or unfair dealing between them, and even to combine them in such instances. No argument was

---

22. Thus in *National Leather Co. v. Massachusetts,* 277 U.S. 413, a franchise tax on a parent corporation which conducted all of its business in the taxing state, measured by assets employed including the stock in two subsidiaries which tanned leather for it in the same state, was sustained. The Court said that the facts showed that the parent employed the stock of the subsidiaries in its business. The reverse could not possibly have been true.

23. New Jersey did not, in *F. W. Woolworth Co. v. Director,* 45 N.J. 466, 213 A. 2d 1, deeming a finding of fact that unity was present sufficient to support a consolidation. The court emphasized the fact that it was a parent whose franchise was being valued. The court also emphasized (213 A. 2d at 8) that the case was not one of "distinct products, services and functions separately conducted . . . through subsidiaries." The court itself thus distinguished the case before it from one such as the instant case.

24. Prior to the decision below, the lone California decision was *Edison California Stores v. McColgan,* 30 Cal. 2d 472, 183 P.2d 16 (1947), where the facts stated by the state court justified the disregard of the corporate entity and the opinion, though ambiguous, could have meant to rest on that ground. It was not so construed below, nor in *Zale-Salem, Inc. v. State Tax Comm.,* 237 Ore. 261, 391 P. 2d 601 (1964), which sustained the taxing technique employed here.

25. Rev. & Tax Code §§ 25102, 25103 and 25104. App. 26-28.

made by the tax administrator or the Court of Appeal that this was such a case, and the code sections were not relied on. Instead the general allocation section, which one would have thought from its face[26] was intended to apply to business done by a single corporation, was relied on.

This Court has considered two cases where a state attempted to combine parent and subsidiary in a single franchise tax. In *Southern Ry. Co. v. Kentucky*, 274 U.S. 76, this Court held the attempt invalid. Kentucky assessed the parent, which had no trackage in the state but owned a subsidiary which did. The state sued the parent for a franchise tax, allowing a credit for the franchise tax paid by the subsidiary. This Court held the asserted tax invalid as an effort to reach extraterritorial property, because it found that the "operating results of the system, compared with those . . . in Kentucky show that" the Kentucky values were very much less than the system average. (274 U.S. at 83) The Court did not, accordingly, find it necessary to consider whether the parent could have been taxed had the asserted tax been properly apportioned.[27]

The second case is *National Leather Co. v. Massachusetts*, 277 U.S. 413, where the Massachusets franchise tax was asserted against the parent, which had its commercial domicile in the state, measured by property owned, including the capital stock of two subsidiaries. The Court chose to sustain the tax on the ground that the parent used the stock of the subsidiaries in its business. The subsidiaries tanned leather uppers in Massachusetts which the parent resold. Thus no question of extraterritorial taxation was presented beyond the claim that the mobilia doctrine placed the stock

---

26. Rev. & Tax. Code § 25101, App. 25-26.

27. Mr. Justice Brandeis filed a lone dissent in which he indicated that he would have joined in the decision had he thought that the federal question was seasonably raised below.

of the subsidiaries outside Massachusetts because the parent was incorporated in Maine. The decision sheds no light here.

By contrast, this Court has held that a state does not acquire jurisdiction over the parent merely because it owns a subsidiary over which the state does have jurisdiction. *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, an opinion written by Mr. Justice Brandeis for the unanimous court which is almost contemporaneous with the *Southern Railway* case. The decision rested on the view that "the defendant, a foreign corporation, was not within the state" (267 U.S. at 336) for purposes of service of process, which was what was involved. Thus California could not sue Kennecott for a tax; instead it has assessed the tax against Kennecott's subsidiary.

Moreover, in *Hoeper v. Tax Commission*, 284 U.S. 206, this Court held that a state cannot tax a natural person on the income of another natural person. There are limitations to this doctrine, of course, but it has not been undercut as a general constitutional proposition. There are also limitations to its applicability to affiliated corporations, we know, but the question whether a state which elects to enjoy the advantages of a corporate franchise tax is limited to measuring the tax on that franchise by its values is vividly suggested by it.

As in *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, here no case is made for a disregard of the corporate entity of either parent or subsidiary, as the state recognized when it stipulated that Kennecott did not do business in California. Having elected to observe the corporate entity by taxing its exercise, the state should be required to confine its tax to the value of what it taxes.

Under this Court's decisions, there is, accordingly, a federal question which is substantial and unresolved.

V. California's action herein raises substantial questions of discrimination against members of affiliated groups. The questions can be raised not only under the Equal Protection Clause but also under the Due Process Clause[28] and the Commerce Clause.

The discrimination lies in the fact that Chase's competitors, although they buy copper from Kennecott at the same price as Chase, do not have to pay a California tax measured by any of Kennecott's net income. Two independent fabricators, Revere Copper & Brass and General Cable, annually purchased a combined total of 87,000 tons of copper from Kennecott (App. 19), some of which was shipped to their California plants (App. 37). Asarco owned about one-third of their stock (App. 19), and Kennecott none. They would not be consolidated for California franchise tax purposes with each other, with Asarco or with Kennecott, since none of them owned more than 50% of the other.

The illustrations can be multiplied. The point is that a subsidiary finds it must pay more in taxes to California than an independent competitor.

This discrimination is unconstitutional. Multi-state operations involve interstate commerce of course. A burdensome classification between competitors merely because of stock ownership is an unreasonable burden on commerce, and a denial of due process unless the differences arising because of stock ownership justify that classification.

No significant advantages are shown to adhere to Chase because Kennecott owns its stock. This discrimination against it raises substantial federal questions.

---

28. Discrimination violative of the equal protection clause can also violate the due process clause. *Bolling v. Sharp*, 347 U.S. 497; *Detroit Bank v. United States*, 317 U.S. 329; *Currin v. Wallace*, 306 U.S. 1; *Chas. C. Steward Mach. Co. v. Davis*, 301 U.S. 548.

CONCLUSION

Substantial federal questions are presented. Probable jurisdiction should be noted and a plenary hearing on the merits granted.

Respectfully submitted,

VALENTINE BROOKES
601 California Street
San Francisco, California 94108
Attorney for Appellant

Appendix A

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed—Apr 29 1970

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,

Plaintiff and Respondent,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Defendant and Appellant.

Franchise Tax Board of the State of California (herein, the Board) appeals from a portion of a judgment in the amount of $231,257.32 plus interest, which was awarded to plaintiff in this lawsuit to recover taxes paid under protest. The taxes are upon the franchise to do business in California during the years 1954, 1955 and 1956; but in order to make the reading easier, operations and relationships among companies are sometimes narrated, in this opinion, in the present tense.

Plaintiff, Chase Brass and Copper Co., Incorporated, is a wholly owned subsidiary of Kennecott Copper Corporation. The principal question is whether plaintiff's business is unitary or nonunitary with Kennecott, and a lesser question is whether plaintiff's business is unitary with any of Kennecott's other subsidiary corporations. If the business be unitary, a much larger franchise tax would be imposed than if the business be nonunitary. It is not always unfavorable as to tax for a corporation to conduct a unitary

business; for example, in the leading cases of *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, *and Honolulu Oil Corp. v. Franchise Tax Board,* 60 Cal.2d 417, the corporations asserted, successfully, that their California operations were unitary with those conducted outside the state.

In the case before us, plaintiff computed its California income, using an allocation formula which is applied to non-unitary enterprises and which takes into account sales, property and payroll within the state as compared with those existing outside. The Board disagrees with this method of computation; it has assessed taxes at a much higher figure on the "unitary business" theory.

The Corporations

The parent is Kennecott Copper Corporation (called Kennecott herein), the nation's largest producer of copper, a New York corporation. It does no business in California. It mines, smelts and refines copper, gold, silver and molybdenite. The metals are mined in Utah, Nevada, Arizona and New Mexico. Metals other than copper are sold in operations completely unrelated to plaintiff. Copper is not fabricated by Kennecott, but is sold through a subsidiary of Kennecott, Kennecott Sales Corporation.

Braden Copper Company, a Maine corporation, wholly owned by Kennecott, operates mines in Chile. Ordinarily, it sold copper to the government of Chile and to purchasers in the world market, but not buyers in the United States. In the years relevant hereto, however, because of shortages, it did sell, through Kennecott Sales Corporation, in this country. Plaintiff was a buyer. Braden does not fabricate; it sells fungible copper.

Bear Creek Mining Company, a Delaware corporation, owned by Kennecott, explored for metals in California in the relevant years, but made no significant discoveries. It

is the third company in the mining group consisting of Kennecott, Braden, Bear Creek.

The procedure beyond mining and refining of copper, sales, is committed to Kennecott Sales Corporation (herein, Kennecott Sales), a New York corporation, wholly owned by Kennecott, which in 1934 took over the sales and activity theretofore assigned by Kennecott and Braden to an independent agency. The sale of copper by Kennecott and by Braden within the United States is done by Kennecott Sales. No sales are made in California; Kennecott does no business here. Its sales of copper which enters this state are completed elsewhere. Kennecott Sales charges Kennecott a commission on the sales.

Kennecott Wire and Cable Co., (herein, Kennecott Wire), a Rhode Island corporation, owned by Kennecott, manufactures copper rod, wire and cable for transmission of electricity. It uses refined primary copper, all of which it buys from Kennecott or Braden through Kennecott Sales. Its sales operation in California is largely through plaintiff. Kennecott Wire did not do business in California in the relevant years.

Finally, there is plaintiff, Chase Brass and Copper Co., Incorporated, a Connecticut corporation, wholly owned by Kennecott. Like Kennecott Wire, it is a manufacturer. Its products are brass (made of copper and zinc), bronze (copper and alloys, mostly tin), and copper rod, sheet, wire and tube. The manufacture is done entirely outside California. Copper is bought from Kennecott Sales, derived from Kennecott and Braden, to the extent of 80 to 84 percent of Chase's needed supply. Within California, Chase warehouses and sells its products and those of Kennecott Wire.

The Franchise Tax Law

When a corporation engages in multistate business, including business in California, and the business is unitary,

there must be an allocation of income by formula. Separate accounting is not allowable, although it is usable for a corporation which, by operating here and elsewhere, conducts a nonunitary business. In the case of Chase itself, it was always recognized by the company that its own business is unitary, wherefore its own computation of the franchise tax was done according to formula. But the Board contends that the geographic unitary character of Chase is not all that is to be considered; there must also be taken into account the whole intercorporate parentage and affiliation of the Kennecott family. Mainly, it is the vertical aspect which is put before us: the relationship of Chase to Kennecott Sales, to Braden and to Kennecott. Secondarily, there is to be considered the horizontal relationship of Chase to Kennecott Wire.

Intercorporate unitary character of business, in which the activities of the parent are considered, under an appropriate factual situation, is a valid concept for taxing purposes. (*Edison California Stores v. McColgan,* 30 Cal.2d 472.) This holding of the *Edison Stores* case was but a logical sequence of the holding in *Butler Brothers v. McColgan,* 17 Cal.2d 664, in which a single company had operated through wholly controlled branches. In both cases, there were strong and embracing central controls. The general test which we are to apply is this: "If the operation of the portion of the business done within the state is dependent upon or conrtibutes to the operation of the business without the state, the operations are unitary." (*Edison California Stores v. McColgan, supra,* at p. 481; *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 412.) A more particular statement of the test is that a business is unitary if these circumstances are present: "(1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions;

and (3) unity of use of its centralized executive force and general system of operation." (*Butler Brothers v. McColgan, supra,* at p. 678; *Superior Oil Co. v. Franchise Tax Board, supra,* at p. 412.)

In applying these tests, we are considering a question of law only, because the facts, as placed before the trial court and before us, consist of a lengthy stipulation between the parties and some uncontradicted testimony. We must, therefore, make our own judgment on the question of law, and we cannot rest upon findings of fact made by the trial judge. (*Standard Register Co. v. Franchise Tax Board,* 259 Cal.App.2d 125, 129-130; *Household Finance Corp. v. Franchise Tax Board,* 230 Cal.App.2d 926, 930; *Montgomery Ward & Co. v. State Board of Equalization,* 272 A.C.A. 823, 828-829. See also *RKO Teleradio Pictures, Inc. v. Franchise Tax Board,* 246 Cal.App.2d 812, 816; *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 413.)

Unity of Ownership

As is usual in disputes of this kind, ownership of one corporation by another is present. This means, of course, that the owner (its stockholders and directors) expects, or at least hopes, that its subsidiary will make a profit. But more is required for a business to be unitary, that is, fulfilment of the other two tests.

Unity of Operation

Although there is not a clear demarcation between what is "operation" and what is "use," in general it may be said that the acts falling within the category of "operation" are the staff functions, and those within "use" are the line functions.

The staff functions of a vertically integrated enterprise probably are not so markedly unitary as they are in a horizontally integrated business. This is so because, in the case of horizontal integration, functions such as central control of advertising of the same product, central purchasing, and the like are designed to give advantages to the business despite geographic differences. In the case of vertical integration involving various steps in the production and distribution, integration of staff functions probably will be considerably less. Nevertheless, when we consider each of the functions of Chase coming under the heading "Unity of Operation," in connection with those of its parent, Kennecott, we find considerable cooperation.

Purchasing: Under this heading, we consider the buying of items other than the purchase of copper, because copper buying is an essential "line" function. As to the auxiliary supplies, it is stipulated that Chase had its own purchasing department staffed by its own personnel. But Kennecott does some "minor" purchasing for Chase. In some instances, insurance was purchased for two or more companies in order to obtain a more favorable rate or better coverage or a better spread of risk. There was no intercompany coverage on basic industrial policies such as fire, fire use and occupancy, workmen's compensation, public liability, automobile liability and fire, sickness and accident, hospitalization and surgical, and certain types of bonds.

Advertising: Chase maintains its own advertising program and budget. The name and trademark of Chase are predominant in its advertisements, but these often contain a statement that Chase is a subsidiary of Kennecott. When Chase places advertising through an advertising agency, it uses the same agency that is used by Kennecott.

Accounting: Kennecott and Chase keep separate books of account, but the two use the same accounting firm.

Kennecott prepared consolidated tax accounts for Chase.

Legal: Chase has its own legal staff and on occasion employs its own outside counsel. Presentation of the protest of Chase before the Franchise Tax Board in these proceedings was handled by Kennecott employees.

Financing: In 1955, Chase's mill at Waterbury, Connecticut, was severely damaged by flood. Kennecott made loans to Chase, in the amount of $10,000,000, for rehabilitation of the plant. The prime bank rate of interest, which was then three and a half percent, was charged. The loan, including interest, was repaid within four years. We find this to be substantial evidence of unity of operation. It may be that Chase could have borrowed the money from lending institutions, but the fact remains that it could turn readily to its parent for help. It must have been deemed advantageous to the over-all management to have handled the transaction in this way, otherwise a separate arrangement would have been made.

Retirement Plan: There is a common retirement plan for salaried employees, which is administered by Kennecott, because when it was installed it appeared to be more economical and because it assures salaried employees in each company the same treatment as those in other Kennecott companies.

Unity of Use

Unity of use relates to executive forces and operational systems. (*Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 415.)

Executive Forces: The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or, in case of failure or indifferent results, debited) with the effects of corporate enter-

prises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. The stipulation of facts reads: "The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." The "major policy matters" are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott.

Not only was there opportunity for control at the highest levels. The salaries of Chase's executives (and of those of Kennecott Wire) who earned more than $15,000 a year were subject to review by Kennecott. Exercising regulation of salaries of Chase's executives, even of those who were compensated at a not particularly sizable figure, Kennecott could control costs of management. Besides, these executives could hardly fail to recognize that their compensation

was dependent upon the decision of Kennecott's salary committee.

It is true that the president of Chase had a complete staff and line organization under his direction, but executive control at the highest level was in Kennecott.

Chase and Kennecott Wire: Inextricably bound to Chase's vertical relationship with Kennecott is its horizontal tie with Kennecott Wire. In fact, the relationships between Chase and Kennecott Wire, described in this paragraph, are evidence of the central control of these sibling corporations by their parent, Kennecott. Who would decide the extent of the horizontal relationships and whether the joint activities were mutually advantageous to the siblings, and commonly so to the parent, but the parent itself? Kennecott Wire, like Chase, is a manufacturer. Since 1944, Chase has taken over the sales of the major part of the products of Kennecott Wire. Chase warehouses the products of Kennecott Wire; Chase salesmen call on prospective wire and copper customers. If the salesmen obtain orders, they send them to Kennecott Wire. The orders are filled and shipped in the name of Chase. Chase receives a discount on the products sold. Chase does much of the accounting and reviews the taxes for Kennecott Wire. The former president and the general sales manager of Kennecott Wire had been Chase employees. Although the products, all of them composed to some extent of copper, are different, the activities clearly show a unitary business. (*RKO Teleradio Pictures, Inc. v. Franchise Tax Board,* 246 Cal.App.2d 812.) Respondent argues that unity of ownership is absent. In form this is correct, but in substance the unity of ownership is present because Kennecott is the sole owner of Chase and of Kennecott Wire.

Purchase of Copper: Kennecott sells about 20 percent of its total copper production to Chase through Kennecott

Sales. During the relevant years, there was an industry-wide copper shortage so that Kennecott would have had no difficulty in selling copper to others. This does not mean, however, that there was no contribution at all to Kennecott by Chase except the profits which Chase might make and which would redound to the benefit of Kennecott as sole stockholder. Although the three years, 1954, 1955 and 1956, are the only ones involved in the present case, these years are not the only ones in which the two corporations have been interested for their anticipated prosperity. Chase has been owned by Kennecott since 1929. To have a buyer of a substantial portion of the parent's production throughout the years must be assumed to be an advantage.

It is the position of respondent that Chase gained no particular advantage during the years in question by reason of the parentage of Kennecott. Kennecott sold to Chase at exactly the same price as that which it charged Chase's competitors. Moreover, during the period of shortage an allocation was made based on prior sales. Respondent does not contend that price equality was the result of benevolence toward other consumers, including competing companies. The equality was under compulsion of the Robinson-Patman Act (15 U.S.C. § 13a). But it is argued that under these conditions Chase is no more unitary with Kennecott than is, for example, another large buyer from Kennecott, Revere Copper & Brass Company. Here, again, however, we remark that the three years are not the only ones to be considered. The percentage which governed the amount of copper allocable to Chase was built over the years.

The fact of the sales alone, however, whether specially advantageous to Kennecott or to Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control

of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary.

Except for the matter of sales and joint ownership, Braden and Chase are not unitary. We support the conclusion of the trial judge to this extent. As to Bear Creek, too, there is no such relationship as would allow formula computation of the taxes on the unitary theory. We agree with respondent on another point, namely, that Kennecott's sales of gold, silver and molybdenite metals, which are not bought by Chase or Kennecott Wire, are not part of the unitary business. The fact that these metals come from the same ore as that which produces copper is not sufficient to cause their sales to be included in the computations which are to follow.

The Board concedes that there is error in the property factor as it was applied, because of the decision in *McDonnell Douglas Corp. v. Franchise Tax Board*, 69 Cal.2d 506; wherefore, the case must be remanded in any event. Our decision requires further revisions of the formula.

We reverse the judgment, with directions to the trial court to proceed in accordance with this opinion.

Devine, P. J.

We concur:

Rattigan, J.

Christian, J.

Appendix B

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed—May 28 1970

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,

Plaintiff and Respondent,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Defendant and Appellant.

OPINION ON DENIAL OF PETITION FOR REHEARING

By the Court:

This is in response to requests by the parties for further rulings and explanation:

1. The formulary taxation procedure is not in itself a simultaneous process of taxing and of disregarding the separate entity of the taxed corporation. (*Edison California Stores v. McColgan*, 30 Cal.2d 472, 481.)

2. We do not regard the case of *Norfolk & Western Ry. Co. v. Missouri State Tax Comm.*, 390 U.S. 317, to be decisive or even relevant to the case at hand. In the *Norfolk* case, the railroad was able to show, by actual count of its rolling stock on the lien date, that the number of units within Missouri was substantially less than that which had been assumed by the taxing authorities, and that a certain "enhanced value" theory proposed by the taxing authorities would require a challenge to a total value figure which had

been agreed upon. The case is far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted.

3. Since the formula must be recomputed, the special issues relating thereto, which our opinion has not resolved, are to be presented to and tried by the trial court (the subject of the gold, silver and molybdenum operations, however, has been decided by our opinion).

The petition for rehearing is denied.

Dated: May 27, 1970

Devine, P. J.

Appendix C

Filed Mar-1968

Superior Court of the State of California
For the City and County of San Francisco

No. 538595

Chase Brass & Copper Co., Incorporated,
Plaintiff,

vs.

Franchise Tax Board of the State of California,
Defendant.

FINDINGS OF FACTS AND CONCLUSIONS OF LAW

The above-named case came on regularly for trial on November 14, 1966. Plaintiff was represented by Kent, Brookes and Anderson, appearing through Valentine Brookes. Defendant was represented by Thomas C. Lynch, Attorney General of the State of California, appearing through Ernest P. Goodman, Assistant Attorney General, and John J. Klee, Jr., Deputy Attorney General. Having considered all the evidence and the briefs submitted by the parties, the Court now makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The facts stated in the Stipulation of Facts on file herein are true and the Court hereby adopts said Stipulation as findings of this Court.

2. The testimony of the witnesses offered by plaintiff is uncontradicted and the Court finds that the facts stated by said witnesses are true. In that regard, the Court specifically finds that:

(a) The fair market value of Kennecott's mining properties (including the equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$585,346,677
January 1, 1955	577,317,053
January 1, 1956	568,978,394
January 1, 1957	560,180,039

The Fair market value of Braden's mining properties (including equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$141,606,405
January 1, 1955	141,475,283
January 1, 1956	141,133,657
January 1, 1957	140,779,691

The value of the equipment and reduction facilities at the mine sites, if owned by someone who could not use them in conjunction with the mines, would be mere salvage value.

(b) On February 12, 1952, the Republic of Chile required Braden thereafter to sell all copper it mined in Chile to the Chilean Government under Law No. 10255. The Chilean government set the price at which it would buy the copper, and then resold it at a profit to itself of about eleven cents a pound. While Law No. 10255 was in effect, Braden sold its copper to the Chilean Central Bank for the price set by the Chilean Government at 24½ cents per pound. This price was the same as the one in effect for sales of domestically

produced copper in the United States under federal copper price-control regulations promulgated during the Korean War. But World copper prices prevailing outside the United States averaged about 35½ cents per pound, and this was the price which the Chilean Central Bank obtained for its sales of Braden copper on the world market, and for its exports of copper to the United States. Since Chilean Central Bank personnel lacked experience in the international copper market, the Bank appointed Kennecott Sales the selling agent for all Braden copper so sold. This law was in effect until May 31, 1955, when it was repealed by Law No. 11828.

(c) The Chilean Government's Copper Department effectively set minimum prices at which exports could be sold after March 28, 1956. This was done by the Copper Department's pressure on the major Chilean copper producers, Braden and Anaconda, to enter into unpublicized agreements to sell all Chilean copper at the highest price prevailing on any of the major metal markets. As a result, Braden copper was sold in the United States domestic market at the London Metal Exchange price. The purpose of the Chilean action was to maximize its tax revenues from the copper producers.

(d) The Copper Department of the Chilean Government issues an export license for every ton of copper exported from Chile. In this manner, the Chilean Government assures a supply of domestically mined copper for the Chilean industrial users of copper. Braden, therefore must supply local Chilean industry with any amount of copper that they ask for. In some years, Braden has delivered substantial quantities of copper to Chilean industry, while in other years, it has delivered relatively little; in the years here involved, it delivered to Chilean industry from 4% to 16% of its annual production.

(e) Because it is fire-refined copper and not electrolytically refined copper, Braden copper was not well suited to sale on the United States market except for use in brass and bronze. It was customarily sold in the world market and not in the United States. Kennecott copper being electrolytically refined was sold in the United States market. When United States demand exceeded domestic supply (such as in early 1956), Braden Copper was imported into the United States. If it was to be used for conductive purposes it required re-refining, so it was largely sold for alloying into brass and bronze.

(f) The price of copper in the European market generally fluctuates more than does the domestic "producers' price." In the early part of 1956 when copper was in great demand, the European price was 87 cents per pound, whereas the domestic "producers' price" remained at 36 cents per pound.

(g) Neither Kennecott nor Braden has ever had an internal sales organization to sell its copper production. Prior to 1934, each sold its copper through an independent agency which received $1.00 per net ton commission. In 1934 Kennecott Sales was formed and took over the function of selling agent for Kennecott and Braden. Kennecott Sales was compensated therefor on the same commission basis that the independent agency had been. During the years 1954, 1955 and 1956, Kennecott Sales received $1.00 per net ton commission for sales of Kennecott's copper.

When Chilean law required Braden to sell its copper to the Central Bank of Chile, Kennecott Sales was appointed the Central Banks' selling agent for export sales of this copper, and was paid ½% of the net sale proceeds as commission. From May 1955 through March 1956, Kennecott Sales received $1.00 per net ton commission on sales of Braden copper. After March 1956 the commission was $1.25

per net ton. No tax authority of the United States or Chile has ever questioned the reasonableness of the commissions paid to Kennecott Sales.

(h) In the years in question, Braden had net profit on molybenite and Kennecott had net profit on metals other than copper, principally gold, silver and molybdenite, in the following amounts:

	1954	1955	1956
Braden	$ 1,786,328.29	$ 2,633,771.88	$ 2,611,516.06
Kennecott	30,321,857.61	32,743,300.57	34,835,182.66
Total	$32,108,185.90	$35,377,072.45	$37,446,698.72

For purposes of this finding, "net profit" means gross sales price less direct expenses incurred after the particular metal has been separated from the copper. "Net profit" does not take into consideration any indirect expenses, such as overhead, or any direct expenses incurred in the mining, concentrating or smelting of the ore prior to the time the copper bearing material is separated from the material containing these other metals; for internal accounting purposes, Kennecott treats all such direct expenses and indirect expenses as costs of producing copper.

(i) During the years 1954, 1955 and 1956, Kennecott operated oil properties jointly with Continental Oil Company. The Franchise Tax Board did not include that joint venture within the group of corporations which it determined constituted a unitary business. During these years, the books and records of the joint venture showed a loss.

(j) Kennecott Sales sells the copper produced by Kennecott and Braden to a relatively few customers. None of these customers other than Chase or Kennecott Wire are related by stock ownership to Kennecott. It is customary for Kennecott Sales to supply from 25 to 70 percent of the

copper requirements of any large fabricator to which it regularly supplies copper. During the years 1954, 1955 and 1956, Kennecott supplied to two independent fabricators, Revere Copper & Brass and General Cable, a combined annual average of about 87,000 tons of copper. About one-third of the stock of each of these companies was then owned by American Smelting and Refining Company, a major custom smelter and copper refiner. Nevertheless, Kennecott Sales supplied about 50% of Revere's copper requirements and about 60 percent of General Cable's.

(k) Anaconda, Phelps Dodge and Kennecott are the three big copper producers. Phelps Dodge's fabricating divisions consume all or nearly all of Phelps Dodge's copper production. Anaconda asks its customers not to ship the copper Anaconda produces to independent fabricators, but to use the Anaconda fabricating facilities instead. Because of this, it is doubtful that Chase and Kennecott Wire could buy substantial amounts of copper at the producer's price from any United States source other than Kennecott Sales. The producer's price is the price charged by the primary producers of unwrought copper; primary producers are the companies such as Kennecott, Anaconda and Phelps Dodge that are integrated from the mining through refining stages of copper production. The customer smelter's price is the price charged by companies such as American Smelting and Refining Company that smelt and refine reclaimed copper and copper mined by others. In the years 1954, 1955 and 1956 the producers' price was, on the average, lower than the custom smelter's price. The custom smelter's price fluctuates more often and over a greater range than does the producer's price.

(l) Neither Kennecott nor Kennecott Sales has ever used its market position to help Chase or Kennecott Wire acquire

a customer, although the opportunity to do so has existed. In times of copper shortages, Kennecott does not supply its subsidiaries copper more favorably than it supplies its other customers. Kennecott policy is one of not favoring Chase or Kennecott Wire in any way over any of its customers.

(m) The apportionment formula used by defendant operates to assign to Chase income earned by the income-earning activities of Kennecott, Braden and Kennecott Sales. Since the income-earning activities of all the corporations are separate and distinct and capable of ascertainment by reference to the operation of market forces, there is no need to resort to an artificial redetermination by formula of the incomes of each corporation.

(n) Chase's business activities are not so inter-related with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business contact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent marketplace.

(o) Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership.

3. In computing the assessed tax, defendant included in the numerator of Chase's property factor property in transit to California destinations in the following average amounts:

1954	1955	1956
$180,414.00	$296,282.00	$322,496.00

By stipulation, plaintiff and defendant agreed not to litigate the propriety of this adjustment. The parties agreed that one-half of the above sums for each year would be included in the numerator of Chase's property factor.

CONCLUSIONS OF LAW

From the foregoing findings of fact, the Court reaches the following conclusions of law:

1. Chase was not engaged in a unitary business with Kennecott, Braden, Kennecott Wire, Kennecott Sales or Bear Creek, collectively, or with any one or more of them. Accordingly, it was improper for the Franchise Tax Board to compute the California income of Chase and Bear Creek by the combined report approach. It was also improper for the Franchise Tax Board to assess Bear Creek's asserted tax liability to Chase.

2. In view of the foregoing conclusion of law that Chase was not engaged in a unitary business with any other corporation, this Court deems it unnecessary to determine any of the following issues presented by plaintiff:

(a) Whether defendant's particular apportionment formula was a proper one for consolidating the group's property, payroll, sales and net income.

(b) Whether defendant's assessment violated the equal protection clause of the Fourteenth Amendment to the United States Constitution.

(c) Whether defendant's assessment violated the interstate commerce clause of the United States Constitution (Art.I, § 8, cl. 3).

(d) Whether defendant's assessment violated the foreign commerce clause of the United States Constitution (Art. I, § 8, cl. 3, and the exclusive interest of the national government that its relations with Chile embodied in treaties and informal agreements be free from interference by California.

(e) Whether defendant's assessment violated pre-emptive federal legislation establishing the taxable status of Western Hemisphere Trade Corporations (Int. Rev. Code of 1954 §§ 33, 901-905, 921-922).

3. The Franchise Tax Board did not act unreasonably or arbitrarily in excluding from the property factor Chase's investment in the construction in progress at its Waterbury, Connecticut plant.

4. Plaintiff is entitled to judgment in the sum of $231,257.32, together with interest thereon from July 12, 1963, as provided by law.

Let judgment be entered accordingly.

Dated: March 6, 1968.

/s/ EDWARD MOLKENBUHR

.....

Judge of the Superior Court

Appendix D

In the Court of Appeal of the State of California
First Appellate District, Division Four

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,
Plaintiff and Respondent,
vs.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Defendant and Appellant.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Chase Brass and Copper Co., Incorporated, the Plaintiff and Respondent above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeal of the State of California holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with that of its parent, Kennecott Copper Corporation, and with that of Kennecott Sales Corporation and Kennecott Wire and Cable Co., entered in this action on April 29, 1970 (Petition for Rehearing denied by the Court of Appeal on May 27, 1970; Petition for Hearing denied by the Supreme Court of California on June 24, 1970), reversing to that extent the judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: July 10, 1970.

/s/ VALENTINE BROOKES

Valentine Brookes

Counsel for Petitioner and Respondent

I hereby certify that on this 10th day of July, 1970, three copies of the Notice of Appeal to the Supreme Court of the United States were mailed, postage prepaid to:

Thomas C. Lynch, Attorney General
John J. Klee, Deputy Attorney General
State of California
350 McAllister Street
San Francisco, California 94102,

counsel for Respondent and Appellant. I further certify that all parties required to be served have been served.

/s/ VALENTINE BROOKES
Valentine Brookes

1600 International Building
601 California Street
San Francisco, California 94108

Counsel for Petitioner and Respondent

Appendix E

CONSTITUTIONAL PROVISIONS

The Commerce Clause (Art. I, § 8, cl. 3):

"The Congress shall have Power . . . to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

The Due Process Clause (Amend. XIV, § 1):

"[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

STATUTES

California Revenue and Taxation Code:

25101. Basis of allocation. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such a manner as is fairly calculated to apportion such income among the states or countries in which such business is conducted. Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.

If the Franchise Tax Board reallocates net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to him the basis upon which its reallocation has been made.

(Added by Stats. 1955, p. 1644, in effect June 6, 1955. Adopted without change from former Section 24301.)

25102. Taxpayer owned or controlled by the same interests. In the case of two or more persons, as defined in Section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net income was that of one taxpayer, or to distribute, apportion, or allocate the gross income or deductions between or among such taxpayers, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper income of any such taxpayers.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303.)

25103. Corporation benefiting its members or stockholders by transactions at less than fair price. In the case of a corporation doing business within the meaning of this part, whether under agreement or otherwise, in such manner as either directly or indirectly to benefit the members or stockholders of the corporation, or any of them, or any person or persons, directly or indirectly interested in such business, by rendering services of any nature whatsoever, or acquiring or disposing of its products or the goods or commodities in which it deals, at less than a fair price therefore, the Franchise Tax Board, in order to prevent evasion of taxes or clearly to reflect the income of such corporation, may require a report of such facts as it deems

necessary, and may determine the amount which shall be deemed to be the entire net income allocable to this State of the business of such corporation for the calendar or fiscal year, and compute the tax upon such net income. In determining the entire net income the Franchise Tax Board shall have regard to the fair profits which, but for any agreement, arrangement, or understanding, might be or could have been obtained from dealing in such products, goods or commodities.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303a.)

25104. Consolidated report of parent and subsidiary corporations. In the case of a corporation liable to report under this part owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation liable to report under this part and owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary. The Franchise Tax Board is authorized and empowered, in such manner as it may determine, to assess the tax against either of the corporations whose net income is involved in the report upon the basis of the combined entire net income and such other information as it may posses, or it may adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net income earned by said corporation or corporations from business done in this State.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303b.)

25105. Ownership or control. Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303c.)

Appendix F

Selected Portions of the Stipulation of Facts

IT IS HEREBY STIPULATED by and between the parties hereto by their respective counsel that for the purpose of trial of the above entitled case the facts hereinafter stipulated are true and correct and may be treated by this court as facts proven in open court.

• • •

2. The statements set forth below are applicable to the calendar years 1954, 1955, and 1956, unless otherwise specifically indicated.

3. (a) Kennecott is a corporation of the State of New York, with its main office in the City of New York. It is qualified to do and does business in many states of the United States, but it was neither qualified to nor did it do business in the State of California during the years in question. Kennecott is a publicly held corporation, its stock being listed on all major exchanges.

(b) Chase is a Connecticut corporation organized under the laws of the State of Connecticut in the year 1909, with its principal office and place of business in Waterbury, Connecticut. It has manufacturing establishments located in the State of Connecticut and in the State of Ohio. It is qualified to do business and is doing business in more than twenty-five states of the United States, including California. Ownership of all the capital stock of Chase was purchased by Kennecott from outsiders in the year 1929, and since then all of its capital stock has been wholly owned by Kennecott.

(c) Kennecott Wire, during the period in question, was a corporation of the State of Rhode Island. All its outstanding capital stock was purchased from outsiders by

Kennecott in 1935 and has been owned by Kennecott at all times since; after that stock acquisition, its name was changed from American Electrical Works to its present name.

(d) Bear Creek is a corporation of the State of Delaware. Bear Creek has done business in California and many other states. It qualified to do business in California on October 16, 1945. It formally withdrew from California on May 27, 1960, but again qualified on May 21, 1962, and continues to do business in California. Its stock is wholly owned by Kennecott.

(e) Kennecott Sales is a corporation of the State of New York. It is not qualified to do business in California. The stock of Kennecott Sales is wholly owned by Kennecott.

(f) Braden is a corporation incorporated in the State of Maine. It does no business in the United States and has neither assets (except bank accounts and securities) nor employees in this country. Braden is a wholly owned subsidiary of Kennecott. For federal income tax purposes, Braden qualifies as a Western Hemisphere Trade Corporation and files its federal tax returns on that basis.

4. (a) The principal business activity of Kennecott was and is the production of copper and other metals present in copper-bearing ore. This involves the mining, beneficiation, smelting and electrolytic and fire refining of copper-bearing ores and the selling of the metals and metallic compounds produced from the ores. Kennecott produced the following percentages of United States production of principal metals it produced:

	Gold	Silver	Molybdenum	Copper
1954	20.722	7.476	24.347	25.838
1955	21.919	10.410	26.500	25.247
1956	21.942	8.351	28.593	25.456

Kennecott was the largest copper producer, the second largest gold producer, the fourth largest silver producer and the second largest molybdenite producer in the United States in these years. Kennecott does not engage in manufacturing or fabrication in any way, other than such fabrication or manufacturing as it may do in its own shops for use in its various divisions, but this fabrication or manufacturing is not of products for sale.

Kennecott owns and operates as its western divisions, four mining properties in the United States, one being located in each of the States of Utah, Nevada, Arizona, and New Mexico. The products of Kennecott's four western divisions consist primarily of copper, gold, silver, molybdenite, and minor amounts of other metals, including selenium, platinum and palladium.

The copper as sold by Kennecott is in the usual commercial forms, such as slabs, cakes, ingots, ingot bars, cathodes, billets, and wire bars and copper precipitates. As such, the copper is fungible and is not in the form of commercial end use products.

Some of the copper is sold as blister copper, in which form it is used in the preparation of fungicides and chemicals, and in some cases it is further refined by the purchaser. Precipitate copper, which is obtained by leaching the waste piles, is sold in minor quantities for making pigments and for metallic power purposes, and the balance is not sold as precipitate but is fed into the smelter with other copper concentrates.

Some of Kennecott's copper (produced only at the Chino, New Mexico, Mines Division), is sold as fire-refined copper and is used primarily for non-electrical purposes and for producing certain types of brass and bronze but is not customarily further refined.

The balance of the copper, which is the major portion, is sold after being electrolytically refined and made usable for fabrication into brass mill or into wire mill products.

(b) Chase is primarily engaged in the manufacture and sale of brass, copper rod, sheet, wire, and tube, such products usually being designated in the trade as "brass mill products." Chase owns no mines, and does no mining, concentrating, smelting or refining of metals or ores. Chase is not engaged in the business of buying and selling virgin copper. The copper received by it, with minor exceptions, is changed in form by fabrication or by melting and then fabricating or by melting and combining with other metals to form alloys and then fabricating. Chase's sales are almost wholly domestic. In a typical year it will sell products to more than 18,000 accounts.

(c) Kennecott Wire's principal business during the years under consideration was the fabrication and sale of copper rod, wire and cable for electrical transmission purposes, such items being commonly designated and referred to as "wire mill products." In addition, it fabricated some nonferrous wire for the screencloth business, and also some aluminum wire and cable. Kennecott Wire owns no mines, and does no mining, concentrating, smelting or refining of metals or ores.

(d) The sole business activity of Bear Creek was the performance of mineral exploration and development services for Kennecott on a fee basis. The services it performed for Kennecott in California have never resulted in discoveries. It performed such services in the taxable years.

(e) The sole business activity of Kennecott Sales is the sale of all the metals produced by Kennecott and Braden to customers in the United States and abroad, except (a) gold and silver, which are sold directly by Kennecott; and

except (b) certain copper produced by Braden and sold for use in Chile under governmental regulation. • • •

(f) Braden owns and operates copper mines and milling, smelting, and fire refining equipment in Chile, which it owns in the Chilean equivalent of fee simple.

5. (a) In the years involved Kennecott was managed by a Board of Directors consisting of fifteen members, one of whom was an officer of Kennecott, except that in a portion of 1954 two directors were officers of Kennecott. None of the directors were residents of California. The Board of Directors of Kennecott did not handle the day to day operations of Kennecott's various divisions or subsdiaries. Rather, day to day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters.

(b) The Board of Directors of Chase consisted of eight members. They are elected by Kennecott as the sole stockholder of Chase. Save for three officers of Kennecott, the directors of Chase, during the period in question, were all officers of Chase and residents of Connecticut. However, none of the three Kennecott officers attended a meeting of the Chase Board during the period in question. No em-

ployee or officer of Kennecott was an officer of Chase during the period in question or since.

During the three years in question, the President of Chase was Richard C. Diehl, whose office was at the main office of Chase in Waterbury, Connecticut, and from which office he directed the affairs of Chase. His time and attention were given to Chase; he was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all the other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

(c) The members of Kennecott Wire's Board of Directors were elected by Kennecott as sole stockholder. The Board consisted of either eight or nine members, of which at times five and at times four were officers of Kennecott. The quorum of the Board was three. No meeting was held in 1954, 1955 or 1956 at which an officer of Kennecott was present except for one emergency meeting held on December 28, 1955, when the President had suffered a cerebral hemorrhage and no quorum was available without Kennecott officers; the only business transacted at the meeting was a change in signatures on a bank account so that funds could be withdrawn during the President's incapacity. No employee or officer of Kennecott was an officer of Kennecott Wire during the period in question, or has been since. During the period in question, the President of Kennecott Wire was Alan F. Sheldon, whose office was at the headquarters of Kennecott Wire in Phillipsdale, Rhode Island. His time and attention were given to Kennecott Wire and he was not responsible for the business operations of

Kennecott or any of Kennecott's other subsidiaries. He also had a complete staff and line organization, which, under his direction, carried out the fabricating, pricing, selling (except such as was done by Chase under the arrangement described in paragraph 7) purchasing, record keeping, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

(d) Braden and Kennecott had common directors and officers. Charles R. Cox, the President of Kennecott and Braden, was the only Kennecott director common to Braden and Chase, to Braden and Kennecott Wire, and to Chase and Kennecott Wire.

6. The manner in which Chase conducted its business in the State of California has not changed substantially in all of the years that it has been qualified to do business in the State except for the sale of Kennecott Wire Products referred to in Paragraph 7. It did not act as an agent or representative of Kennecott or sell or otherwise dispose of any property owned by Kennecott. In general, its business dealings with Kennecott were confined to the purchase from Kennecott of virgin copper and the sale to Kennecott of relatively small amounts of merchandise as produced by it. Its purchases from Kennecott are effected from its main office in Waterbury, Connecticut. All of Chase's shipments into the State of California are in the form of products manufactured from copper or other metals or combinations thereof.

7. Until July 1, 1944, Kennecott Wire sold its products either directly through its representatives located in states in the Middle West or the Northeast or, in some cases, through distributors. By 1944 it had become apparent that Kennecott Wire could not continue operations as in the

past, because better outlets and warehouse stocks of certain of its products were needed at convenient locations. As a result of studies which were made as to what should best be done, on July 1, 1944, Kennecott Wire entered into an agreement with Chase whereby Chase took over the sales, through its various sales offices and warehouses throughout the United States, of the major part of the products of Kennecott Wire. Certain high volume accounts which could be supplied by carload lot shipments from the factory in the Northeast, were retained by Kennecott Wire and sold directly. Under this arrangement, Chase purchased stocks of products from Kennecott Wire, placed them in various of its warehouses, and then resold them in the areas covered by such warehouses. Additionally, Chase salesmen called on prospective wire and cable customers whether or not there was stock in the warehouses to which such salesmen were assigned to secure orders for products of types produced by Kennecott Wire. These orders were then transmitted to Kennecott Wire at its home office, the stock was produced by Kennecott Wire and billed and shipped in the name of Chase, with Chase receiving a discount on the products sold. Further, certain of Kennecott Wire's employees did promote sales of the products it produced, either alone or in conjunction with Chase's sales activities.

Prior to the Kennecott Wire—Chase agreement, Kennecott Wire did not have extensive warehousing facilities. After the agreement, it did not maintain any stocks of wire and cable in the Chase warehouses. When there was a stock of wire or cable in the Chase warehouses, it was the property of Chase, not Kennecott Wire. Under the

arrangement described above Chase did sell in the years in question Kennecott Wire products to customers in California.

8. Kennecott has no employees in California. Kennecott employees did not supervise Chase employees in California or elsewhere.

9. In the years in question, 1954, 1955 and 1956, no representative of Kennecott Sales was in the State of California for the purpose of selling, attempting to sell, or soliciting sales of metals for which it is the agent, nor for the purpose of missionary work of any type, nor was any representative of Kennecott in California for such purpose or purposes. The shipments into California were the result of negotiations outside California.

10. During the period in question, Kennecott shipped 14,032 tons of copper into California. Nearly all of this amount was bought by General Cable, American Smelting and Refining Company, and Revere Copper & Brass Company on orders negotiated with Kennecott Sales and placed by those companies through their New York offices. None of these corporations is owned or controlled by or affiliated with Kennecott or any corporation owned or controlled by it. There was no solicitation or direct dealing with the branches of these companies in the State of California. Twelve thousand tons of Braden copper were shipped to the General Services Administration of the United States Government on a contract made in Washington, D.C. for stockpiling in California.

In 1956 Kennecott also sold to the Mountain Copper Company Limited at Martinez in California twelve drums of copper precipitate totaling 3,035 pounds for what was understood to be an experimental order, and 30 tons of copper to the Chicago plant of H. Kramer & Company of

El Segundo, California. The only other shipments into the State of California in the years in question were of selenium, sold to the International Rectifier Company at El Segundo, California, and to Owens-Illinois Glass Company at Los Angeles and Oakland, California. In 1954, Kennecott sold International 3,350 pounds of selenium for $24,300; in 1955, 5,000 pounds for $59,400; and in 1956, 6,050 pounds for $105,400. On orders received from the main office of Owens-Illinois at Toledo, Ohio, Kennecott shipped to that company's plants in California 2,350 pounds of selenium in 1954 and 700 pounds in 1955. These sales were not solicited or obtained by Kennecott in California. None of the purchasing corporations is owned or controlled by or affiliated with Kennecott or by any corporation owned or controlled by or affiliated with it.

11. (a) The property of Chase in the State of California included inventories of the products which it was engaged in selling, located in warehouses either owned or leased by it in the City of South San Francisco and in the City of Los Angeles. The balance of Chase's California property consisted of real estate, office furniture, fixtures, machinery and equipment. It maintained a sales office at the warehouses in South San Francisco and in Los Angeles. It had no more than fifty-one employees either living in the State of California or representing it in the State of California.

• • •

Throughout the United States, Chase had 7,617 employees on December 31, 1954, 8,197 employees on December 31, 1955 and 6,731 employees on December 31, 1956. In California it had 44 employees on December 31, 1954, 43 employees on December 31, 1955, and 50 employees on December 31, 1956.

(b) Of Chase's total sales in the years in question approximately 3.8% in 1954, 4.5% in 1955 and 4.9% in 1956 were to customers in California. Of Chase's sales of wire mill products, approximately 4.1% in 1954, 2.5% in 1955 and 4.5% in 1956 were to customers in California.

The amount of Chase's sales to California customers during the years here involved were:

1954	1955	1956
$6,506,833.00	$9,589,614.00	$10,422,917.00

12. (a) The amount of virgin copper purchased by Chase and Kennecott Wire from Kennecott is determined by the needs of Chase and Kennecott Wire; the amount of copper to be required for operations for a given month is estimated by Chase and Kennecott Wire, and Chase, which buys scrap, then subtracts from this amount the tonnage of copper content of scrap to be purchased from its own customers or from other sources such as scrap dealers. The balance usually represents the amount purchased from Kennecott.

• • •

14. Kennecott, through Kennecott Sales, sells to Chase approximately 20% of its total production of copper and sells to Kennecott Wire approximately 4%, leaving about 76% which it sells to its other customers.

15. Those products produced by Chase and Kennecott Wire which were purchased by Kennecott were purchased at the going price which was the same price as was charged any other customer. The amount of sales by Chase and Kennecott Wire to Kennecott and its affiliates (exclusive of the sales by Kennecott Wire to Chase which were made for resale as described in paragraph 7) for the years here involved were:

1954	1955	1956
$329,982.00	$301,285.00	$451,039.00

16. In order that Kennecott and its subsidiaries might operate at the lowest possible cost, and in some instances, to assure results compatible to all the companies in which Kennecott owned stock, certain matters were handled either jointly or on a uniform basis, and they were as follows:

(i) Salaries of more than $15,000 for employees of Chase and of Kennecott Wire were submitted to Kennecott's Salary Committee.

(ii) There was some purchasing of supplies on contracts negotiated by Kennecott, but this was minor. Ordinarily, Chase and Kennecott Wire purchased from outside sources of each's own selection.

(iii) There were minor charges between the companies, but these charges were in no case greater than would have been charged by or to a company not affiliated with Kennecott.

(iv) There were some instances in which insurance coverage could be combined for two or more companies, with a more advantageous rate, or better coverage, or a better spread of risk. In one instance the cost of separate coverage would have been prohibitive. The charges in every case were prorated on an allocable basis. Kennecott could have secured the coverage desired without covering the subsidiaries. There was no intercompany coverage on basic industrial policies such as Fire, Fire U. & O., Workmen's Compensation, Public Liability, Automobile Liability and Fire, Sickness and Accident, Hospitalization and Surgical and certain types of bonds.

(v) There was a common Retirement Plan for Salaried Employees, which was administered on an overall basis by Kennecott in New York. The reason for having one

Retirement Plan is that, at the time it was installed, it appeared more economical. It also assured salaried employees in each company the same treatment as those in the other companies.

The Pension Plans for Hourly Employees, which covered hourly employees, were not only not uniform but also they did not cross the border between corporations, i.e., no Kennecott hourly employee was covered by a Chase or Kennecott Wire Plan, nor, conversely, were the employees of Chase or Kenecott Wire covered by the Kennecott Plans, nor did Chase and Kennecott Wire Plans cover employees of the other. Each corporation had a separate Plan or Plans, and each bore its own cost of administration.

17. There has been some interchange of employees between the various corporations identified in paragraph 1, but very little interchange between Kennecott and the fabricating companies, Chase and Kennecott Wire; not more than six salaried employees have been transferred to or from the fabricating companies and Kennecott in the last twenty years.

There have been no more than sixteen instances of transfer between Braden and Kennecott in the last fifteen years.

Employees have moved from the employment of Chase to Kennecott Wire and from Kennecott Wire to Chase. The former President of Kennecott Wire came from Chase, as did the General Sales Manager and an engineer. Officers and employees have also come from outside employment; viz., Charles Cox, president of Kennecott, from U.S. Steel Corp., Richard Diehl, president of Chase, from Wheeling Steel Corp., and Glenn Bakken, executive vice president of Chase, from Reynolds Metals Corp. When Chase entered

into the arrangement to sell most of the products of Kennecott Wire, it employed some salesmen and sales engineers previously employed by Kennecott Wire.

If there were hourly employees who transferred from one company to another, the transfers were made on their own account and not on company request.

18. Chase received loans from Kennecott totaling $10,000,000.00 to rehabilitate the Waterbury mill plant which was severely damaged in the flood disaster of 1955. On these loans, Chase was charged interest at the rate of 3½ per cent, which was equal to the prime bank rate of interest. All funds borrowed plus interest were repaid within four years.

19.(a) Chase handled its own personnel policy and industrial relations and did its own negotiating in labor matters. The labor advisor for Kennecott sometimes exchanged information with Chase relative to preparation of union contracts and rates of pay for various skills.

(b) Chase maintained its own administrative offices and kept its own separate books of account. It had its own accounting and internal audit staff, and handled its own tax matters with the exceptions noted below. In addition to its own manufacturing operations it had its own credit, purchasing and traffic departments, its own sales force, and its own research department and laboratory. These were staffed with its own personnel. Kennecott Wire prepared and sent Chase invoices to Chase customers for many sales by Chase of Kennecott Wire's products. Kennecott and Chase both made contributions to the Copper and Brass Research Association.

(c) Chase maintained its own internal advertising department and staff which worked independently in the

preparation and publication of material which advertised Chase products. Chase developed its own advertising program and budget, which was not submitted to Kennecott for advance approval. When Chase placed advertising through an advertising agency, it used the same agency that Kennecott used. The name and trademark of Chase is predominant in its advertisements in trade journals, magazines and newspapers. These advertisements often contain as part of the Chase trademark the statement that Chase is a subsidiary of Kennecott Copper. Kennecott's advertising often stressed the importance of "adequate wiring."

(d) In addition to its own manufacturing operations Kennecott Wire had its own personnel, purchasing, traffic and research departments which were staffed with its own personnel.

(e) In Chile, in addition to its own mining, milling, smelting and refining operations, Braden maintained its own administrative offices and its own purchasing, traffic, research, personnel and accounting departments which were staffed with its own personnel.

(f) Kennecott and all the subsidiaries used the same public accounting firm. Consolidated accounting and the preparation of certain tax reports were done by Kennecott in New York. During the years in question, Chase did the accounting and reviewed the taxes for Kennecott Wire for a fee. Kennecott furnished Braden whatever accounting, administrative and legal services Braden had a need for in the United States, and for this service Kennecott charged Braden a fee. Kennecott furnished Bear Creek and Kennecott Sales accounting, administrative and legal services for a fee.

(g) Chase had its own legal staff and on occasion employed its own outside counsel. Kennecott furnished Kennecott Wire with legal services for a fee. Kennecott employees handled the preparation and presentation of the protests of Chase and Bear Creek before the Franchise Tax Board in these proceedings.

20. On occasion, there have been loans of specialized personnel from Chase to Kennecott and from Kennecott to Chase, but these occasions have been infrequent. Also, Kennecott had two employees working at Chase for a period of approximately two years on a joint research program exploring the question of the compacting of titanium powder, a product of Quebec Iron & Titanium Corp.

• • •

21.(i) Kennecott sold its copper to all its customers, including Chase and Kennecott Wire, at what is called the "producers price." Kennecott did not charge Chase or Kennecott Wire prices for copper that differed from prices it charged its other customers. The "producers price" is the price, published in trade journals, which is charged for domestic copper by the three giants of the copper industry: Kennecott, Anaconda, and Phelps Dodge. During periods when the copper fabricators are demanding more copper than is being produced by Kennecott, Kennecott would sell to its customers, including Chase and Kennecott Wire, on an allocation basis. The allocation procedure, which was normally based on amount of purchases during a particular test period, was determined by the management of Kennecott and Kennecott Sales, and was not used to give Kennecott subsidiaries special purchasing preference over Kennecott's other customers.

Kennecott and Braden deliver substantial amounts of metal annually to a relatively small number of customers.

The following schedules analyze total deliveries to customers for the years 1954, 1955 and 1956:

KENNECOTT COPPER CORPORATION

	1954	1955	1956
Total deliveries (U.S. and foreign) (in tons)	353,513	371,414	364,539
Total number of customers	83	64	70
Deliveries to the 25 principal customers (in tons)	315,572	344,770	343,178
Per cent of deliveries to the 25 principal customers to total deliveries	89%	93%	94%
Per cent of the 25 principal customers to total number of customers	30%	39%	36%
Deliveries to the 10 principal customers (in tons)	250,114	283,134	290,277
Per cent of deliveries to the 10 principal customers to total deliveries	71%	76%	80%
Per cent of the 10 principal customers to total number of customers	12%	16%	14%

* * *

During the years 1954, 1955 and 1956, Kennecott supplied to two independent fabricators, Revere Copper & Brass and General Cable, a combined annual average of about 87,000 tons of copper.

22. (a) In 1906, American Smelting and Refining Company (hereinafter referred to as Asarco) constructed a smelter a few miles from the Bingham Mine of Kennecott in Utah, under a contract by which it smelted the entire output of the Binghham Mine for compensation which was specified in the contract. This arrangement continued in effect until January 1, 1933. This smelter was known as the Garfield smelter.

(b) On January 1, 1933, a new contract called the "Utah Contract" went into effect which gave Asarco the right both to smelt and to refine the entire product of the Bingham Mine. As the Garfield smelter was not a refinery, the refining of the product occurred at Asarco refineries elsewhere, notably in Maryland and New Jersey.

(c) On November 29, 1940, a new contract was entered into between Kennecott and American Smelting and Refining Company. This contract, the "new Utah Contract," took effect January 1, 1943 and continued the right of Asarco both to smelt and to refine the entire product of the Bingham Mine. Under this contract, the refining of the product occurred at Asarco refineries in the States of Maryland, New Jersey and Washington.

(d) Under the "steptoe Contract," dated June 26, 1923 and effective August 1, 1923, Asarco had the right to refine all the Nevada Mine product. As Asarco did not have a refinery in Nevada, this refining was ordinarily done at Asarco's refineries in Maryland, New Jersey and Washington. The Nevada Mine smelted its own product.

(e) Under the "Ray/Chino Contract," dated April 23, 1927 an deffective as of January 1, 1927, Asarco smelted and refined all the product of the Ray Mine and the Chino Mine; its refineries were located in Maryland, New Jersey and Washington. By Agreement dated January 1, 1939, this contract was amended to permit Kennecott, itself, to smelt Chino concentrates and deliver Chino blister copper to an Asarco refinery if Kennecott wished to have it electrolytically refined. Under the "New Ray Contract," dated and effective as of October 1, 1940, the Ray product continued to be smelted and refined by Asarco.

(f) On July 29, 1948, the new Utah Contract was amended to permit Kennecott to build and operate a refinery of its own in Utah, capable of refining 16,000 tons of blister copper per month. Such a refinery was built near the Garfield smelter and became operative at the end of 1951, but since the production of the Utah and Nevada Mines usually exceeded 16,000 tons per month, some product from those mines continued to be refined by Asarco.

Substantially all other electrolytic refining continued to be done by Asarco since the Amendment also provided that product from the Nevada, Ray and Chino mines which Kennecott desires to so refine shall be refined at Asarco's Baltimore, Perth Amboy or Tacoma refineries.

• • •

(j) Kennecott and Asarco each owned 50 percent of the Garfield Chemical and Manufacturing Co., a producer of a by-product sulphuric acid located at the Utah smelter, until by purchase contract dated February 6, 1964, Kennecott acquired 100% ownership of the chemical company.

• • •

(l) Neither Kennecott nor its subsidiaries have owned stock in Asarco. Asarco has owned stock in Kennecott during the taxable years involved and thereafter but such ownership has been only about 1% of the total shares issued by Kennecott. Asarco has never owned stock in the Kennecott subsidiaries herein involved. In the taxable years involved, for many years prior and continuously since, the stock of both Kennecott and Asarco has been listed and actively traded on the New York Stock Exchange .Each corporation is and has been publicly owned.

23. The Franchise Tax Board determined that Chase was engaged in a unitary business with Kennecott, Kennecott Wire, Kennecott Sales, Braden and Bear Creek. The assessment against Chase was computed accordingly.

• • •

27. In computing the California portion of the unitary income, the Franchise Tax Board used the usual three-factor formula of property, payroll and sales. The Board did not employ a "production factor" composed of the expenses of mining and manufacturing in its formula. Since all the mining and manufacturing occurred outside California, such a "production factor" would be 0% for California for each of the years here involved.

• • •

30. No assets of any nature were owned jointly and no company leased space or property to another; however, Bear Creek and Kennecott Sales shared facilities at Kennecott's headquarters in New York.

31. No consolidated federal or state tax returns were filed.

• • •

35. For the years 1954, 1955 and 1956, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income as net income is defined by Rhode Island law, and Rhode Island did not allocate any part of said Kennecott Wire net income to other states.

For the years 1954, 1955 and 1956, Kennecott Sales paid to the State of New York tax on its entire corporate net income as net income is defined by New York law, and New York did not allocate any part of said Kennecott Sales net income to other states.

• • •

THOMAS C. LYNCH
Attorney General

By /s/ JOHN J. KLEE, JR.
JOHN J. KLEE, JR.
Deputy Attorney General
Attorneys for Defendant

/s/ VALENTINE BROOKES
VALENTINE BROOKES
KENT, BROOKES AND ANDERSON
Attorneys for Plaintiff

Appendix G

Opinions of Certified Public Accountants

1954

Chase Brass & Copper Co., Incorporated and Wholly-owned Subsidiaries

In our opinion, the statements herewith and the foregoing comments present fairly the financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries as at December 31, 1954 and the results of their operations for the year ended on that date, in conformity with generally accepted accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

Respectfully yours,

/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

1955

Chase Brass & Copper Co., Incorporated,
Waterbury, Connecticut.

May 1, 1956.

Gentlemen:

We have made an examination of the accounts of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries for the year ended December 31, 1955 and submit herewith the Consolidated Balance Sheet and related Statements of Income and Surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Consolidated Balance Sheet and Statements of Income and Surplus present fairly

the consolidated financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries at December 31, 1955 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

There are also submitted a Schedule noted on the Index herewith and our comments, which present explanatory and analytical data based on information obtained from the accounts and records of the Company and as furnished to us by officers and employes.

Respectfully yours,
/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

1956

Chase Brass & Copper Co., Incorporated,
Waterbury, Connecticut.

April 30, 1957.

Gentlemen:

We have made an examination of the accounts of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries for the year ended December 31, 1956 and submit herewith the Consolidated Balance Sheet and related Statements of Income and Surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Consolidated Balance Sheet and Statements of Income and Surplus present fairly the consolidated financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries at December 31, 1956 and the results of their operations for the year then ended, in conformity with generally accepted

accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

There are also submitted a Schedule noted on the Index herewith and our comments, which present explanatory and analytical data based on information obtained from the accounts and records of the Company and as furnished to us by officers and employes.

Respectfully yours,

/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

Appendix H

When the Franchise Tax Board combines several corporations into one "unitary group", and applies its formulary allocation methodology as it has in this case, algebraically the allocation methodology proceeds through two steps. The board usually uses a short form of calculating the result which tends to obscure the fact that two steps are being taken. Here we prove algebraically (in Part A below), and then demonstrate arithmetically (in Part B below), the presence and the result of the two steps in the case at bar. Finally, we compute, year by year, the re-determination by formula of Chase's net income (in Part C below).

The first step is to apportion a part of the group's combined income to each corporation included in the combined group, not on the basis of the established accounting principles ordinarly used in determining an independent corporation's net income, but on the basis of a formula which assumes that each corporation earns the same in proportion to property, payroll and sales.

The second step is to allocate to California a part of the income apportioned to each corporation in the first step.

A. ALGEBRAIC PROOF.

Why the two steps are implicit in the board's methodology is shown algebraically as follows. (To keep the proof from becoming unwieldly only the sales factor will be used; the relationship set out is true whether one or more equally weighted factors are used, and is independent of of their number.)

The board's formula for determining Chase's California income is as follows (See, Stip., Exh. P):

$$(1)\quad \frac{\text{Chase's California sales}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \text{Chase's California income}$$

The first fraction in expression (1) is the board's sales factor. It compresses two steps into one, thus:

$$(2)\quad \left\{ \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \right\} = \frac{\text{Chase's California sales}}{\text{Group's sales everywhere}}$$

By substituting the left half of expression (2) into expression (1) where the board's sales factor appears, we can rewrite expression (1) as follows:

$$(3)\quad \left\{ \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \right\} \times \text{Group's combined income} = \text{Chase's California income}$$

But the standard statutory formula for determining the California income for a single corporation is as follows (this is the method Chase used in its California tax returns and which we insist is proper):

$$(4)\quad \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \text{Chase's total income} = \text{Chase's California income}$$

Upon comparing expression (4) with expression (3), we find that the left half of both expressions is equal to the same thing, Chase's California income. It therefore follows that the left halves of both expressions are equal to each other. Writing this out, we can cancel common fractions on opposite sides of the equal sign, as follows:

$$(5)\quad \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \text{Chase's total income}$$

Hence, expression (5) rewritten proves that the board's formula necessarily redetermines Chase's corporate net income:

$$(6)\quad \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \text{Chase's total income}$$

The foregoing proof is, perhaps, a proof of the obvious. Nevertheless, we feel compelled to make it, for it is the essence of our disagreement with the California taxing agency. In short, expression (5) shows how the board has used its formula to redetermine Chase's total corporate net income. We used expression (4) to determine Chase's California net income. We object to the use of expression (5) to determine Chase's corporate net income, which is easily ascertained by reference to the independent marketplace where its income and expenses are readily identified.

B. ARITHMETIC DEMONSTRATION.

We now demonstrate arithmetically how the board has redetermined Chase's corporate net income. We select Chase's income year 1956 for our demonstration.

For purposes of the demonstration, we assume the most favorable resolution possible (for the taxpayer) of the issues the Court of Appeal remanded to the trial court.*

We have assumed that the net income from Kennecott's gold, silver and molybdenum is as shown in Plaintiff's Exhibit 2 in the trial court. We have assumed that Kennecott's mines will be put in the denominator of the property factor at the largest possible amount, their fair market value as found by the trial court. Of course, Braden and Bear Creek are eliminated from the consolidation.

The board's determination, as thus adjusted for the Court of Appeal's holding, is as follows (the figures are from Exhibit P to the Stipulation of Facts):

Allocation formula:			
Chase's California property	$ 1,896,827		
Group's property everywhere	$694,650,011	=	.0027306
Chase's California payroll	$ 245,658		
Group's payroll everywhere	$106,087,571	=	.0023156
Chase's California sales	$ 10,422,917		
Group's sales everywhere	$440,358,141	=	.0236692
Total			.0287154
Average			.0095718
Unitary net income of group	$117,913,865		
Chase's California net income (multiply $117,913,865 by .0095718)	$ 1,128,647.93		

Using the board's formula as we have rewritten it in expression (3) in part A above, we enter into the formula the dollar amounts used by the board's auditor in his workpapers (Stip., Exh. P), as adjusted for the Court of Appeal's holding. Chase's California sales are $10,422,917; Chase's sales everywhere are $201,302,912; the group's sales everywhere are $440,358,141; and the group's combined

*There is one remanded issue that our calculations do not assume will be decided in favor of the taxpayer. The issue is whether the three factor formula should be expanded to include a fourth factor. The California numerator of this fourth factor, expenses of manufacture, would be zero since Chase does no manufacturing in California. Hence, the California tax would be reduced by 25 percent if that factor were added, thus reducing the multiplication of Chase's tax approved below from seven-fold to five-fold.

income is $117,913,865. (The parentheses are used below to indicate the redetermination of corporate net income.)

$$\frac{10,422,917}{201,302,912} \times \left\{\frac{201,302,912}{440,358,141} \times 117,913,865\right\} =$$
$$.0517773 \times (.4571345 \times 117,913,865) =$$
$$.0517773 \times (53,902,495.72) = 2,790,925.69$$

We next go through the same calculations for the payroll factor:

$$\frac{245,658}{37,502,669} \times \left\{\frac{37,502,669}{106,087,571} \times 117,913,865\right\} =$$
$$.0065504 \times (.3535067 \times 117,913,865) =$$
$$.0065504 \times (41,683,341.30) = 273,042.56$$

And, finally, for the property factor:

$$\frac{1,896,827}{61,610,028} \times \left\{\frac{61,610,028}{694,650,011} \times 117,913,865\right\} =$$
$$.0307876 \times (.0886922 \times 117,913,865) =$$
$$.0307876 \times (10,458,040.10) = 321,977.96$$

The foregoing calculations reveal two sets of significant figures. These may be summarized as follows:

(1) Factor	(2) Chase's corporate net income as reallocated by each factor in column (1)	(3) Chase's California income as determined by each factor in column (1)
Sales	$ 53,902,495.72	$2,790,925.69
Payroll	41,683,341.30	273,042.56
Property	10,458,040.10	321,977.96
Totals	$106,043,877.12	3,385,946.21
Totals divided by three	$ 35,347,959.04	$1,128,648.74

Because each factor is an equally weighted one-third of the total allocation formula, we must divide each of the totals above by three to reach the ultimate results obtained by the board. Doing so, we have found Chase's corporate net income (column 2) to be $35,347,959.04, and Chase's California income (column 3) to be $1,128,648.74.

Compare Chase's corporate net income calculated here with the amount shown in line 1, column 4 of Schedule 6 in part C below. The amounts are identical.

Compare Chase's California income calculated here with the result obtained by following the board's methodology above. Again the amounts are identical.

Hence, we have demonstrated both algebraically and arithmetically that appellant's formula reallocates Chase's corporate net income, but in the guise of geographical allocation. It is not true, as the board argued below, that its formulary methodology does not have implicit in it a redetermination of corporate net incomes.

C. THE GROUP'S REDETERMINED NET INCOME.

Following the methodology demonstrated in parts A and B above, it is possible to develop for each corporation a corporate property, payroll and sales factor. The numerator of the fraction is the corporation's property, payroll or sales, while the denominator is the total of the "unitary" group's property, payroll or sales. These factors are developed in Schedules 1, 3 and 5 for the income years 1954, 1955 and 1956, respectively. The source of the data is Exhibit P attached to the Stipulation of Facts, which is the board's auditor's work papers in which the deficiency assessment is computed. This data has been adjusted to reflect the holding of the Court of Appeal.

For example, in Schedule 1, line 1, column 1, Chase's corporate property factor is set out. The numerator of the factor is $52,134,505, which is the amount of Chase's property everywhere as shown in line 1, column 1, Schedule II, Exhibit P. The denominator of the factor is $699,559,428, which is the total of the group's property everywhere as adjusted from line 6, column 1, Schedule II, Exhibit P. On the next line in column 1 of Schedule 1, the decimal equivalent of the fraction is set out. Similarly, Chase's

other factors and those of the other corporations are developed in Schedules 1, 3 and 5. In column 4 of these three schedules are shown the corporate income reallocation factors, which are calculated by summing columns 1, 2 and 3 and then dividing by three.

In column 4 of Schedules 2, 4 and 6, for the income years 1954, 1955 and 1956, respectively, are shown the amounts of corporate net income the formula reallocates to each corporation. These net incomes are calculated by multiplying the corporate allocation factors from column 4 of Schedules 1, 3 and 5 (which are also set out in column 3 of Schedules 2, 4 and 6) by the group's total net income (from Exhibit P, Schedules IA, IB and IC). The product is the reallocated corporate net income.

Columns 3 and 4 of Schedules 2, 4 and 6 may be compared with columns 1 and 2 which reflect the corporate net income actually earned by each corporation (from Exhibit P, Schedules IA, IB and IC). Column 1 shows the amount of net income actually earned and column 2 shows what percentage it is of the group's total net income. Finally, column 5 shows the board's reallocated net income as a percentage of the net income that each corporation actually earned in the marketplace.

For example, in the first line of Schedule 2, for the income year 1954, Chase earned $7,871,558 (column 1) or 12.97% of the group's total (column 2). The formula, however, attributes over 32% of the group's total to Chase (column 3), in the amount of $19,818,721 (column 4), for an increase of 252% (column 5).

SCHEDULE 1

INCOME YEAR 1954

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	52,134,505	36,159,453	159,564,138	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.0745248	.4174861	.4875918	32.65342%
Kennecott Wire	3,622,708	2,012,468	4,497,422	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.0051786	.0232353	.0137431	1.40523
Kennecott	643,802,215	48,440,426	163,187,885	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.9202967	.5592785	.4986651	65.94135

SCHEDULE 2

INCOME YEAR 1954

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 1%	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase	$ 7,871,558	12.97%	32.65342%	$19,818,721	252%
Kennecott Wire	1,782,128	2.94	1.40523	852,893	48
Kennecott	50,689,329	83.51	65.94135	40,022,551	79
Kennecott Sales	351,150	0.58	—	—	—
Totals	$60,694,165	100.00%	100.00 %	$60,694,165	

SCHEDULE 3

INCOME YEAR 1955

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	48,914,498	39,599,287	199,430,936	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.0716090	.4162428	.4776925	32.18481%
Kennecott Wire	3,672,483	2,162,430	5,395,073	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.0053764	.0227301	.0129227	1.36764
Kennecott	630,490,340	53,373,362	212,662,106	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.9230146	.5610272	.5093848	66.44755

SCHEDULE 4

INCOME YEAR 1955

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 3	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase (loss)	($ 1,380,516)	—	32.18481%	$ 33,102,597	—
Kennecott Wire	2,660,518	2.59%	1.36764	1,406,640	53%
Kennecott	101,476,492	98.66	66.44755	68,342,377	67
Kennecott Sales	95,120	.09	—	—	—
Totals	$102,851,614		100.00%	$102,851,614	

SCHEDULE 5

INCOME YEAR 1956

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	61,610,028	37,502,669	201,302,912	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.0886922	.3535067	.4571345	29.97778%
Kennecott Wire	3,769,676	2,659,693	4,924,993	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.0054267	.0250707	.0111841	1.38938
Kennecott	629,270,307	65,925,209	234,130,236	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.9058811	.6214226	.5316814	68.63284

SCHEDULE 6

INCOME YEAR 1956

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 5	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase	$ 5,106,554	4.33%	29.97778%	$ 35,347,959	692%
Kennecott Wire	4,536,969	3.85	1.38938	1,638,272	36
Kennecott	108,247,408	91.80	68.63284	80,927,634	75
Kennecott Sales	22,934	0.02	—	—	—
Totals	$117,913,865	100.00%	100.00 %	$117,913,865	

Appendix I

It is an economic fact that since World War II in this country the mining of non-ferrous metal has been far more profitable than its fabrication. This Court may take judicial notice of economic fact. An examination of industry statistics set forth in *The Value Line Investment Survey,* (December 6, 1968) pp. 940-1058, demonstrates the economic fact that mining is more profitable than fabrication. For the years before the Court, the following table shows the percentage of net profit to sales, as set out in *Value Line,* for mining companies, for companies that both mine and fabricate, and for companies that fabricate:

1954-1956 Profitability Comparisons*

	Percent of Profit to Sales				
	1954	1955	1956	Average	Major Products
1. Mining Companies					
American Zinc	7.5	9.3	10.4	9.1	zinc
Campbell Red Lake	53.5	57.4	56.4	55.8	gold
Cerro Corp.	28.8	34.3	19.1	27.4	lead, zinc, copper, gold
Cominco Ltd.	38.0	40.4	39.9	39.4	lead, zinc
Foote Mineral Co.	24.2	24.2	25.3	24.6	manganese, lithium
Hecla Mining Co.	.....	.....	50.9	50.9	lead, zinc, silver
Homestake Mining	32.2	27.7	28.6	29.5	gold
Hudson Bay Mining	44.5	53.2	52.0	48.9	copper, zinc, gold, silver
Inspiration Consol. Copper	41.4	49.0	47.3	45.9	copper
International Nickel	37.2	43.4	40.6	40.4	nickel, copper, other
Kennecott Copper	34.3	50.2	51.8	45.4	copper, other
Magma Copper	33.3	37.2	35.1	35.2	copper
Molybdenum Corp.	9.6	10.7	10.4	10.2	molybdenum, rare earth
St. Joseph Lead	14.5	16.8	14.1	15.1	lead, zinc
Average	30.1	34.9	34.4	34.1	
2. Mining and Fabricating Companies					
Anaconda	17.5	30.5	33.3	27.1	copper, zinc
Copper Range Co.	10.1	34.6	37.0	27.2	copper
Phelps Dodge Corp.	28.1	37.8	37.8	34.6	copper
Average	18.5	34.3	36.0	29.6	
3. Fabricating Companies					
Revere Copper & Brass	13.3	10.9	8.7	10.9	brass mill
Continental Copper	8.3	9.1	13.5	10.3	wire mill
General Cable Corp.	12.4	11.0	14.1	12.5	wire mill
Fansteel Metallurgical	12.0	19.8	24.7	18.8	refractory metals
International Silver	12.1	11.1	9.7	11.0	silver
Average	11.6	12.4	14.1	12.7	

*The information in the above tables was compiled by *Value Line* from consolidated financial statements prepared by the companies in compliance with stock exchange rules. Accordingly, whether mining companies with fabricating subsidiaries are shown in group 1 or 2 depends on the extent of the company's mine production fabricated by the company's fabricating subsidiaries. Kennecott thus appears in the group of mining companies, while Phelps Dodge and Aanaconda appear in the group of mining and fabricating companies.

The table clearly shows that mining is more profitable than fabricating. The average percent of net profit to sales for predominantly mining companies is 34.1%. The average percent of net profit to sales for companies that mine and fabricate drops to 29.6%. Finally, the average percent of net profit to sales for companies that simply fabricate drops to 12.7%. *Value Line* shows the percent of net profit to sales for all the foregoing companies for the years 1952 to 1967. A presentation of those percentages is unnecessarily cumbersome, but the same relationships do appear. Mining tends to be more than twice as profitable as fabricating. It is revealing to note that, for those companies which both mine and fabricate, the fabricating operation pulls the company's over-all profit percentage down from the high mining profit percentage to a percentage closer to the lower fabricating profit percentage.

MOTION FILED
SEP 28 1970
LIBRARY
SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

On Appeal From the Court of Appeal of California, First Appellate District

MOTION FOR LEAVE TO FILE AND BRIEF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA AND THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

NATIONAL ASSOCIATION OF MANUFACTURERS OF THE UNITED STATES OF AMERICA

LAMBERT H. MILLER
General Counsel
1133 Fifteenth Street, N. W.
Washington, D. C. 20005

COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE

GEORGE S. KOCH
Counsel
1028 Connecticut Avenue, N. W.
Washington, D. C. 20036

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

On Appeal From the Court of Appeal of California, First Appellate District

---

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

The Committee on State Taxation of the Council of State Chambers of Commerce and the National Association of Manufacturers hereby respectfully move for leave to file the attached brief *amici curiae* in this

case. The consent of the Attorney for the Appellant has been obtained. The consent of the Attorney for the Appellee was requested but refused.

The Council of State Chambers of Commerce (COUNCIL) organized in 1932, consists of 31 Chambers of Commerce (composed of 27 state and 4 Regional Chambers). Its function is to provide advice to the member chambers on important national and state issues affecting the general conduct of business and to represent its membership in appropriate situations. The COUNCIL's Committee on State Taxation (COST), one of the COUNCIL's four advisory committees, consists mainly of multi-corporate enterprises which conduct a substantial portion of the multistate and interstate business in the United States. One of COST's principal activities has been to work toward developing fair and equitable national standards in the income allocation and apportionment aspects of state taxation.

The National Association of Manufacturers (NAM) is a non-profit voluntary business organization organized as a membership corporation under the laws of the State of New York. It is composed of approximately 14,000 manufacturing and related concerns located throughout the United States and represents a substantial proportion of the nation's industrial employment. The majority of these concerns engage in interstate commerce to some degree.

Member companies of COST and NAM, therefore, are representative of that part of the nation's business sector which is most directly affected by state taxation, including corporate franchise taxes, upon multistate and interstate business operations. COST and

NAM are obviously and vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty and fair apportionment of taxes in each of the fifty states.

The particular interest of COST and NAM in this case is that it presents the fundamental and far-reaching issue of the extent of a state's power under the Due Process and Commerce clauses to tax corporations operating within that State upon the basis of income earned outside of the state by independently operated out-of-state affiliates.

This Court's review of this case and its establishment of constitutional standards for state taxation of multistate businesses are urgently needed for the orderly growth of interstate commerce in the United States. They are also needed to provide a reasonably consistent and fair system of taxation throughout the nation which will allow each state to receive its just share of the total tax contribution of the nation's business sector. Finally, such review is needed to protect the constitutional rights of taxpayers in this era of rapidly increasing state and local revenue needs and the states' tendency toward delegation of the taxing authority among numerous local government units.

By this motion COST and NAM seek leave (1) to show that the decision of the Court of Appeal of California in this case is directly repugnant to long standing judicial interpretation of the Due Process and Commerce clauses of the Constitution and (2) to show the wide and adverse effect upon multistate business operations that decision will have, unless this Court undertakes to resolve the conflict presented.

We, therefore, urge that leave be granted to file a brief as *amici curiae* and respectfully so move the Court.

Respectfully submitted,

Laurence H. Mirer
General Counsel
1133 Fifteenth Street, N. W.
Washington, D. C. 20005

Gerson S. Koen
Counsel
1028 Connecticut Avenue, N. W.
Washington, D. C. 20036

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

On Appeal From the Court of Appeal of California, First Appellate District

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AND THE NATIONAL ASSOCIATION OF MANUFACTURERS, AS AMICI CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, is reported at 7 Cal. App. 3d 99, 86 Cal. Rptr. 350 (1970); and its opinion on denial of petition for rehearing is reported at 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970).

INTEREST OF AMICI CURIAE

The interest of the Committee on State Taxation (COST) of the Council of State Chambers of Commerce and the National Association of Manufacturers (NAM) is set forth in the accompanying Motion for Leave to File Brief *Amici Curiae*.

ARGUMENT

The crux of the decision of the Court of Appeal of California in this case is that it imposes a franchise tax upon Chase Brass and Copper Co. (CHASE) measured by income earned by independent corporate affiliates of Chase which income is in no way attributable to business operations within the State of California. It is a tax based, therefore, upon wholly extra territorial considerations which the Court traditionally has regarded as an undue burden upon interstate commerce under the Commerce clause and a violation of the "nexus" and "minimum connection" requirements of the Due Process clause.

The constitutional test established by the court requires that a state tax on interstate enterprise may not be sustained where the tax reaches activities carried on beyond the borders of the state. Where a state income tax reaches profits which are in no sense attributable to transactions within its jurisdiction, the Court has held the tax to be constitutionally invalid. *Hans Rees Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).

California's application in this case of the "combined reporting" or "unitary" approach in the taxation of multicorporate enterprises violates this fundamental standard. As more fully described in the Jurisdictional Statement of Appellant, it includes with-

in the basis for determining the amount of Chase's franchise tax liability the income earned by Kennecott Copper Corporation (KENNECOTT), Kennecott Wire and Cable Co. and Kennecott Sales Corporation on the sole ground that Kennecott owns controlling stock interest in Chase and the other Kennecott companies. The California Court disregards the facts that (1) neither Kennecott nor its subsidiaries, other than Chase, do any business in California, (2) Chase is operated independently from Kennecott and its affiliates and (3) all dealings between Chase and Kennecott are conducted at arms' length and all purchases by Chase of Kennecott products are at standard and well established market prices. In other words, this is a case where the evidence, coupled with the application of standard and generally accepted accounting principles, conclusively demonstrates that the income of Chase's independent affiliates is not in any way attributable to operations within the State of California. By disregarding these facts in imposing the tax in this case, California is attempting to tax extraterritorial operations in violation of established constitutional standards.

This issue is of national importance since it potentially affects every state and every enterprise conducting interstate or multistate operations. As noted by Congressman Rodino in his June 11, 1969, statement before the Committee on Rules of the U. S. House of Representatives:

> "The number of jurisdictions taxing [the several hundred thousand companies engaged in interstate commerce] is staggering. There are in effect at the state level 42 sets of corporate income tax laws, 43 sales and use tax laws, 37 capital stock laws and 8 gross receipts tax laws of general ap-

> plicability. In addition, to compound further the chaos and confusion, business taxes are rapidly proliferating on a local level—with sales taxes already imposed by about 3,000 localities, gross receipt taxes by over 1,000 and corporate income taxes by more than 200 local governments."

The potential effect of the Chase case extends to all of the state and local government taxing jurisdictions employing taxes measured by income, and, of course, to any new state or local tax levies of this type.

The full extent of the burden upon national commerce imposed by the decision in this case is substantially compounded by the often discriminatory taxation of multistate enterprises. This is indicated by the fact that while California in this case has treated a multicorporate enterprise on a unitary basis to increase the taxpayer's tax obligation, other states have refused to balance the scales by applying that doctrine to the same taxpayer where it would result in a corresponding reduction in the tax obligation. See *Kennecott Copper Co.* v. *State Tax Comm.* 118 Utah 140, 221 P. 2d 857 (1950), *Kennecott Copper Corp.* v. *State Tax Comm.*, 5 Utah 2d, 306, 301 P. 2d 562 (1956).

The problem was specifically noted by the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the U. S. House of Representatives. That committee noted that "the present 'unitary business' rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole." H. Rep. No. 952, Vol. 4, p. 1155, 89th Cong. 1st Sess. (1965). The Report goes on to state that the establishment of a national standard in this area "will result in a significant measure of relief from the multi-

plicity and diversity of the present system." *Id.* at 1205-06.

Finally, in its study of this problem the House's special subcommittee implicitly anticipated the need for this Court's ultimate resolution of the many conflicts and uncertainties in this area when it stated:

> "First of all, the [unitary business or combined report] concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on a in-State corporation. ***This may arise as a constitutional question*** or in terms of the limitations on State taxing power imposed by Public Law 86-272. In the latter case, the question is whether a State may require a company within its taxing jurisdiction to include in the measure of its tax income from an affiliate which is covered by an exemption in that statute. This question is unsettled, and as a result at least one State, California—the leading exponent of the combined report concept—anticipates that it ***will have to litigate the issues involved.***" (Emphasis added.) H. Rep. No. 1480, Vol. 1, p. 245, 88th Cong., 2d. Sess. (1964)

The serious constitutional problems concerning state taxation of multicorporate enterprises can be resolved only by this Court. The courts of the several States are ever more frequently being confronted with cases involving the federal issues raised by this appeal. *Skelly Oil Co.* v. *Commissioner of Taxation*, 269 Minn. 351, 131 N.W. 2d 632 (1964); *Gulf Oil Corp.* v. *Clayton*, 267 N.C. 15, 147 S.E. 2d 522 (1966); *Square D Co.* v. *Bd. of Tax Appeals*, 415 S.W. 2d 594 (Ky. 1967); *F. W. Woolworth Co.* v. *Director*, 45 N.J. 466, 213 A. 2d 1. The result has been a widening disagreement over the constitutional restraints on the States' power to tax multistate business enterprises and an ever-increasing diversity of patterns of state taxation where uniformity

is needed to prevent over or under taxation of multistate business. The result of this conflict and lack of uniformity is uncertainty as to the rights of interstate and multistate business which will impede the orderly growth of national commerce and promote an unfair apportionment of revenue among the States. The magnitude of these problems inevitably increases as state revenue needs grow and the number of taxing authorities are increased by delegation of state taxing authority to local governments and as the states must increasingly look to interstate and multistate business to meet their tax needs.

CONCLUSION

Amici Curiae submit that the Chase case reflects an arbitrary assumption of state taxing authority which violates established constitutional limitations. The case affords the basis for a needed review by this Court of the right of a state or local government to base a tax upon income derived outside its borders through the application of presumptions in the face of facts to the contrary. Such a review is of high interest to the proper economic development of the United States and to business done within it.

Respectfully submitted,

LAMBERT H. MILLER
General Counsel

Attorney for the National Association of Manufacturers of the United States of America

GEORGE S. KOCH
Counsel

Attorney for the Committee on State Taxation of the Council of State Chambers of Commerce

September, 1970

FILED
OCT 21 1970
SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 761

CHASE BRASS AND COPPER CO., Incorporated,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee.*

On Appeal from the Court of Appeal of California,
First Appellate District

MOTION FOR LEAVE TO FILE AND BRIEF OF THE FINANCIAL EXECUTIVES INSTITUTE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

JOHN B. NOLAN
1250 Connecticut Ave., N.W.
Washington, D. C. 20036
Counsel for Financial Executives Institute

Of Counsel:

STERTON & JOHNSON
Washington, D. C.

PARKS OF ROBERT B. ANDREW PRINTING, INC., WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., Incorporated,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee.*

On Appeal from the Court of Appeal of California, First Appellate District

---

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

Financial Executives Institute hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of the attorney for the appellant has been obtained. The consent of the attorney for the appellee was requested but refused.

The Financial Executives Institute is an individual membership, professional organization composed of approximately 7,000 corporate executives who are responsible for the development of financial policy and the administration of financial affairs of both large and small companies in the United States, Canada and Puerto Rico. The companies with whom FEI's members are associated represent a broad cross-section of American business and industry and they conduct a significant portion of the nation's interstate commerce.

One of the primary objectives of FEI is to provide a means for its members to make joint studies and recommendations on matters of broad financial significance, including developments in state and local taxation which significantly affect business or the environment in which it operates.

The specific interest of FEI in this case is that the decision of which review is now sought constitutes a serious inroad upon the well-established rules that a state may not tax out-of-state corporations upon income not in any way attributable to activities within the taxing state and that common ownership alone does not justify state taxation of one corporation upon the basis of income earned by an independent but affiliated corporation.

In view of the essential role these constitutionally based principles have played in the proper growth and development of the nation's interstate commerce, the potential consequences of the present decision are of the gravest concern to FEI and to the nation as a whole.

Accordingly, FEI hereby seeks leave to file the attached brief as amicus curiae to show the Court that

the present decision threatens to eviscerate some of the most fundamental safeguards against multiple and discriminatory state taxation of interstate business and by so doing would impose an undue burden upon the continued growth of the nation's interstate and foreign commerce.

We, therefore, urge that leave be granted to file the attached brief as amicus curiae and respectfully so move the Court.

Respectfully submitted,

JOHN E. NOLAN
1250 Connecticut Ave., N.W.
Washington, D. C. 20036
Counsel for Financial Executives Institute

Of Counsel:

STEPTOE & JOHNSON
Washington, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., Incorporated,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee.*

On Appeal from the Court of Appeal of California, First Appellate District

---

BRIEF OF FINANCIAL EXECUTIVES INSTITUTE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, is reported at 7 Cal. App. 3d 99, 86 Cal. Rptr. 350 (1970); and its opinion on denial of petition for rehearing is reported at 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970).

INTEREST OF AMICUS CURIAE

The interest of Financial Executives Institute, Inc., (FEI) in this case is set forth in the accompanying Motion for Leave to File Brief Amicus Curiae.

ARGUMENT

Objectively considered, the tax, imposed by the State of California upon Chase Brass and Copper Co. (Chase) in this case, is for all practical purposes a tax upon extra-territorial income of an out-of-state corporation, Kennecott Copper Corporation (Kennecott). Although such taxes have uniformly been held unconstitutional by a long line of decisions by this Court,[1] it was nevertheless sustained by the California Court in this case on the ground that it was a tax, not upon the out-of-state corporation, but upon an independently operated affiliate corporation which does business within California. In this respect the decision in this case is unprecedented.

The harmful effects of the present decision, if allowed to stand, are several and substantial. First, the decision and the tax it upholds are blatantly discriminatory against multi-corporate enterprises.

The real basis for the sevenfold increase in Chase's tax liability in this case is the common ownership between it and Kennecott. It is a tax based, not on the relevant facts of the taxpayer's earnings and operations, but on the completely irrelevant consideration of the taxpayer's affiliation by common ownership with a more profitable out-of-state corporation. By arbi-

---

[1] See, e.g., *Norfolk & Western Ry.* v. *Missouri Tax Comm.*, 390 U.S. 317; *Hans Rees Sons'* v. *North Carolina*, 283 U.S. 123; *Wallace* v. *Hines* 253 U.S. 66.

trarily imposing upon corporations with out-of-state affiliations a substantial tax burden not imposed upon corporations without such affiliations, California is indirectly, but nevertheless plainly, discriminating against multi-corporate enterprises and against the interstate commerce of which those enterprises are a significant part. Moreover, it is an added tax burden for which there is no commensurate increase in services or other benefits from the state which could even purport to justify such discriminatory treatment.

The major vice of the decision in this case, however, is that it sustains a wholly extra-territorial tax on out-of-state income earned by an out-of-state corporation. If this decision is allowed to stand, it means that henceforth with respect to the great majority of multi-corporate enterprises the states are no longer subject to the constitutional limitation that they may tax only activities and values within their borders. The most fundamental safeguard against multiple taxation of interstate business will thus be removed.[2] A fair and equitable system of distribution for tax purposes of income among the fifty states is rendered virtually impossible by a decision such as the present one.

Moreover, the reach of the present decision is not limited to the taxation of income attributable to activities in other states. Extended to its logical conclusion, the decision would allow California to tax corporations operating within its boundaries upon the basis of income earned outside of the United States by

---

[2] The danger of multiple taxation is clearly illustrated by this case where California included in Chase's tax base approximately $5,000,000 of out-of-state net income earned by Kennecott Wire notwithstanding that Kennecott Wire had paid the State of Rhode Island tax on its entire net income.

their foreign affiliates. Indeed, California has already applied its combined reporting requirement to Canadian affiliates of companies operating within California. Carried to its logical end, therefore, California's application of the unitary business concept will interject the states improperly into the delicate area of international trade and relations, contrary to the explicit recommendation of the Report of Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the United States House of Representatives, which states:

> "In keeping with the basic structure of our Federal System, the Committee is of the view that international tax policy should be formulated by the Federal Government and not by individual states.
> * * * * * * * * * *
> Likewise, no State would be allowed to require that such income [from sources outside the United States] be included in the consolidated income of a multicorporate enterprise for apportionment purposes."
>
> H. Rep. No. 952, Vol. 4, p. 1155, 89th Cong., 1st Sess. (1965).

Although the case does not directly involve the taxation of income earned outside of the United States, the foregoing consideration illustrates the grave danger of allowing the states to tax extra-territorial activities simply because multi-corporate enterprise is involved. The traditional territorial and jurisdictional restrictions upon state taxing power which this Court has developed under the Constitution's Commerce Clause have played an essential part in the full development of the nation's business among and between fifty states with varying and often conflicting tax systems. The

present system seeks to erode those restrictions. If it is successful, the result will be a step toward a balkanization of the country's commercial activity which the Commerce Clause was designed to prevent.

CONCLUSION

For the foregoing reasons it is submitted that the decision in this case raises substantial and serious questions under the Commerce and Due Process Clauses of the Constitution and presents issues of great importance to the nation's commercial structure. Accordingly, FEI respectfully supports appellant's request that the Court note probable jurisdiction and grant a plenary hearing on the merits.

Respectfully submitted,

JOHN E. NOLAN
1250 Connecticut Ave., N.W.
Washington, D. C. 20036
Counsel for Financial Executives Institute

Of Counsel:

STEPTOE & JOHNSON
Washington, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal of California, First Appellate District

---

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

Tax Executives Institute, Inc., hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of the attorney for the appellant has been obtained. The consent of the attorney for the appellee was requested but refused.

Tax Executive Institute, Inc. (TEI), is a nonprofit organization whose membership consists of approximately 2,400 corporate and other business executives,

managers and administrators who are responsible for the administration of the tax affairs of their employers. TEI's membership represents approximately 1,600 business organizations a majority of whom engage in interstate commerce. A prime objective of TEI is to promote uniform enforcement of taxes throughout the nation and minimization of the costs of administration and compliance to the benefit of both government and the taxpayers.

TEI represents persons who bear the responsibility and burden of complying with the decision of the Court of Appeal of California which is at issue in this case. In view of the administrative difficulties and uncertainties created by that decision, TEI and its members have a direct and special interest in this case.

By this motion TEI seeks leave to show this Court the practical effect of the decision here involved and, specifically, to show that the decision adds a new dimension to the complexity and disparateness of the national tax structure and by so doing could impose a real and substantial burden upon the interstate activities of all multi-corporate enterprises.

TEI, therefore, urges that leave be granted to file the accompanying brief as *amicus curiae* and respectfully so moves the Court.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.

WILLIAM K. CONDRELL
1250 Connecticut Avenue, N. W.
Washington, D. C. 20036
Counsel

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the Court of Appeal of California, First Appellate District

---

BRIEF OF THE TAX EXECUTIVES INSTITUTE, INC., AS AMICUS CURIAE, IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, is reported at 7 Cal. App. 3d 99, 86 Cal. Rptr. 350 (1970); and its opinion on denial of petition for rehearing is reported at 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970).

INTEREST OF AMICUS CURIAE

The interest of Tax Executives Institute, Inc. (TEI), in this case is set forth in the accompanying Motion for Leave to File Brief Amicus Curiae.

ARGUMENT

TEI is filing this amicus brief because of the interest of its members in achieving reasonable certainty in determining the tax liability of interstate taxpayers and in securing effective compliance with state and local tax laws.

The California Revenue and Taxation Code permits the Franchise Tax Board to require combining of income of affiliated corporations where necessary to clearly reflect the net income derived in California.

The uncertainty concerning tax liability growing out of the potential requirement by a state that a unitary or combined approach be employed was specifically noted in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the United States House of Representatives which stated:

> From the taxpayer's point of view the combined report can produce considerable uncertainty. On the one hand, the taxpayer may not be certain as to whether a combined report will be required. On the other hand, even when it is clear that such a report is required, the taxpayer may be uncertain as to how its income is to be combined and how the combined apportionment factors are to be composed.

H. Rep. No. 1480, Vol. I, p. 245, 88th Cong., 2d Sess. (1964).

The present decision creates equally serious problems in the area of compliance. Application of the unitary business concept generally requires that distinction be made between portions of the corporation's overall income which is attributable to the unitary

business and that which is not. This requires complex determinations as to what constitutes "unitary property," "unitary sales" and "unitary payroll" which must be included within the apportionment formula. The net result is that full and uniform compliance and enforcement is difficult and burdensome since so much depends upon individual judgment which inevitably varies with the hundreds of individuals involved in the administration of the national state tax system. These difficulties were pointed out by the House Special Subcommittee when it stated:

> In addition, even when all of the theoretical uncertainties are removed the combined report can create compliance problems. For example, a corporation which sells various types of products both to its own affiliates and to nonaffiliated customers will have to analyze each sale in terms of whether it is to be included in or excluded from the combined "unitary sales" factor. H. Rep. No. 1480 at 245.

The House Report goes on to describe the end result of this uncertainty and these general compliance problems in the following terms:

> In summary, the present system for the division of income is characterized by diversity and complexity.
>
> * * *
>
> The variety of techniques found in the present system requires extraordinarily complex accounting by the taxpayer who divides income. For any company to attempt to meet the literal requirements of all of these rules would clearly result in unacceptably high compliance costs. As will be seen in later chapters much of this variety is disregarded in practice and a lower order of compliance cost is incurred. The lact of consistency in

> the rules for the division of income also raises the possibility of overtaxation and undertaxation, and a later chapter will show that this problem in fact occurs today.
>
> The present system for division of income is on its face overwhelming. It will surprise no one familiar with it that in practice it works badly. H. Rep. No. 1480 at 249.

This evaluation was accurate in 1964 when the House Report was submitted. It is now even more accurate as a result of the decision of the California Court in this case. The potential effect of the decision in this case is substantial. It will significantly increase the already serious uncertainty regarding the overall state and local tax liability of multi-corporate enterprises. Such uncertainty significantly impedes reasonable tax predictions which are an essential element of good business planning. The issue here involved, therefore, is one of great national importance which should be considered by this Court.

CONCLUSION

For the foregoing reasons, TEI submits that this case presents serious questions of the utmost importance to the economic development of the United States which fully merit this Court's review.

Respectfully submitted,

WILLIAM K. CONDRELL
1250 Connecticut Avenue, N. W.
Washington, D. C. 20036
Counsel for Tax Executives Institute, Inc.

LIBRARY
SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
NOV 19 1970
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

THOMAS C. LYNCH
Attorney General

JAMES E. SABINE
Assistant Attorney General

JOHN J. KLEE, JR.
Deputy Attorney General
6000 State Building
San Francisco, California 94102
Telephone: 415-557-3611

Attorneys for Appellee

BORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

SUBJECT INDEX

	Page
Introductory Statement and Summary of Argument	1
Statement Regarding the Facts and Extent of Hearing Below	9
Argument	12
I. In Computing Income From California Sources, California Follows the "Unitary Business" Concept	12
II. The Activities of Kennecott, Kennecott Sales, Chase and Kennecott Wire Constitute a Unitary Business	17
III. The Facts Relied Upon by Appellant Are Not Persuasive. Appellant's Legal Arguments Are Unsupportable	24
A. The Fact That Chase, Kennecott Wire and Kennecott Sales Are Separately Incorporated Is Not Determinative	25
B. The Fact That Kennecott Also Sold Substantial Amounts of Refined Copper to Independent Fabricators Does Not Mean That Kennecott Is Not Unitary with Chase and Kennecott Wire	26
C. Chase Has Not Been Discriminated Against	29
D. A Group of Related Corporations Can Comprise a Unitary Business Even Though the Different Corporate Members of the Group Perform Different Functions	31
E. The Franchise Tax Board Did Not Attribute to Chase Seven Times More Income Than Chase Actually Earned	34
F. Appellant's Reliance on Norfolk & Western Ry. v. Missouri Tax Comm., 390 U.S. 317, Is Misplaced	37
G. P.L. 86-272 Does Not Prohibit Combined Reporting	40
H. The Unitary Concept Is Valid in Franchise Tax Cases as Well as Income Tax Cases	42
IV. The Arguments of Amici Curiae N.A.M. and C.O.S.T. Are Factually Erroneous and Legally Untenable	44
V. The Arguments of Amicus Curiae F.E.I. Are Completely Untenable	47
VI. The Arguments of Amicus Curiae T.E.I. Are Addressed to the Wrong Forum	50
Conclusion	52

TABLE OF AUTHORITIES CITED

Cases	Pages
Bass, Ratcliff & Gretten, Limited v. State Tax Commission, 266 U.S. 271	49
Butler Bros. v. McColgan, 315 U.S. 501	2, 3, 5, 14, 15, 17, 26, 28, 35, 36, 42, 44, 46, 49
Coler v. Corn Exchange Bank, 250 N.Y. 136; 164 N.E. 882	16
Edison California Stores v. McColgan, 30 Cal. 2d 472, 183 P. 2d 16	16, 18, 30, 35
General Motors Corp. v. District of Columbia, 380 U.S. 553	4, 18, 28
Glass-Tite Industries, Inc. v. State Bd of Equalization, 266 Cal. App. 2d 691, 72 Cal. Rptr. 244	12
Helvering v. Lazarus & Co., 308 U.S. 252	25
Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417, 34 Cal. Rptr. 552	12, 14
John Deere Plow Co. v. Franchise Tax Bd., 38 Cal.2d 214, 238 P.2d 569, appeal dismissed 343 U.S. 939	3, 6, 30, 31, 32, 33, 42, 49
McDonnell Douglas Corp. v. Franchise Tax Board, 69 Cal. 2d 506; 72 Cal. Rptr. 465	12
Norfolk & Western Ry. v. Missouri Tax Comm., 390 U.S. 317	6, 37, 39, 40
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450	41
Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602	42
Studebaker Co. v. Gilchrist, 244 N.Y. 114, 155 N.E. 68	43
Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406, 34 Cal. Rptr. 545	12, 14
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113	17
United States v. Kennecott Copper Corporation, 231 F.Supp. 95, affirmed 381 U.S. 414	11, 31

STATUTES

Pages

Public Law 86-272 ..... 7, 40, 41

15 U.S.C. § 13a 28

TEXTS

Altman & Keesling, Allocation of Income in State Taxation, 2d ed (1950), p. 169 ..... 17, 43

Hellerstein, "Recent Developments in State Tax Apportionment and Circumscription of Unitary Business," 21 National Tax Journal 487 17

Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42, 57 17

McCarthy, "The American Copper Industry, 1947-55," Yale Economic Essays (Spring 1964) 22, 23

Rudolph, "State Taxation of Interstate Business: The Unitary Concept and Affiliated Corporate Groups," 25 Tax Law Review 171 ..... 8, 17

OTHER AUTHORITIES

88 Cong., 2d Sess., H.R. No. 1480, June 5, 1964, Vol. 1, Chap. 7 13

Keesling and Warren, "California's Uniform Division of Income for Tax Purposes Act," 15 U.C.L.A. Law Rev. 156 45

Report of the Federal Trade Commission on the Copper Industry, Government Printing Office, 1947 ..... 20, 21, 22

Willis Subcommittee Report, vol. 4, pp. 1154-5 ..... 45, 50

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal for the following reason:

This case does not present a substantial federal question.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

After analysing the Stipulation of Facts, the numerous exhibits admitted into evidence and the testimony of the witnesses offered by appellant, the California Court of

Appeal concluded that the undisputed facts demonstrated that as a matter of law the activities of Kennecott and three of its wholly-owned subsidiaries (Chase, Kennecott Wire and Kennecott Sales) were dependent upon each other to the extent that it was proper to treat the operations of the group as a "unitary" business.[1] Accordingly, since Chase was doing business in California, the Court held that for purposes of the California franchise tax measured by net income it was proper to compute the amount of income attributable to Chase's California activities by applying a fair apportionment formula to the total unitary net income of the business of which Chase was a part. Appellant has taken this appeal, claiming that the decision is unconstitutional.

In our Argument, which follows a brief statement relating to the facts and the extent of the hearing below, we shall demonstrate that there is no merit to appellant's contentions and that the decision of the California Court of Appeal is in accord with established decisions of this Court. The following is offered as a fair summary of the Argument.

I. In order that this Court can view this case in context, we will first set forth a brief summary of the theory underlying California's approach to corporate income taxation. In that regard, we shall point out that California still follows the "unitary business" concept approved by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501. In applying the unitary business concept, California stresses substance over form. Accordingly, the unitary business rule is applied regardless of whether the related activities are carried on

1. The Court held that two other wholly-owned subsidiaries of Kennecott (Bear Creek and Braden) were not part of the unitary business.

within the framework of a single corporate entity, as in *Butler Bros.*, or by a parent and a group of wholly-owned subsidiaries, as in *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed* 343 U.S. 939.

II. Next, we shall apply the theory to the undisputed facts in this case and show that, beyond any doubt, the activities of the four corporations here involved were interrelated to the extent that it was proper to treat the entire group as a unitary business. Essentially, Kennecott and its subsidiaries are engaged in an integrated copper business, with activities ranging from mining the copper ore down to selling fabricated copper products to consumers. Kennecott mines, concentrates, smelts and refines virgin copper. Chase and Kennecott Wire are copper fabricators. They are dependent upon Kennecott for their basic raw material, refined copper. Kennecott Sales is the intermediary which handles the sales of refined copper. Thus, the corporations present the classic example of a vertically structured business. There existed between the corporations the degree of intercompany contacts that are normally expected in a vertically structured business of this type.

III. In the third section of our Argument, we shall point out the errors in appellant's contentions. In its Jurisdictional Statement, appellant makes numerous assertions to support its position. The arguments are untitled and there are no section headings. For the most part, the contentions overlap and it is difficult to tell exactly what appellant's legal position is, except that it does not like its income computed by the combined unitary method. We shall attempt to pick out the facts relied upon most heavily by appellant and demonstrate why the arguments based thereon are unmeritorious.

A. Appellant stresses the fact that the activities of Chase, Kennecott Wire and Kennecott Sales were carried on by wholly-owned subsidiaries of Kennecott rather than by divisions of Kennecott itself. We do not believe that it is unconstitutional to look to the substance of the business, rather than be controlled by the form in which the business is carried on. To accept appellant's apparent position in that regard would be to write a blueprint for tax avoidance whereby even the most unitary of businesses could lower their State taxes simply by changing the form in which they conduct business. For example, the operations of General Motors Corporation unquestionably present a unitary business situation. See *General Motors Corp. v. District of Columbia*, 380 U.S. 553. Yet, under appellant's approach, General Motors could create "separate businesses" by separately incorporating individual portions of its activities.

B. Appellant relies on the fact that Kennecott, in addition to supplying copper to Chase and Kennecott Wire, sold substantial amounts of copper to independently owned fabricators at the same price. Appellant's reliance on that fact is misplaced. The fact that Kennecott sold refined copper to other companies at the same price it sold to Chase and Kennecott Wire proves at the most only one thing, namely, that Kennecott sold to Chase and Kennecott Wire at a "fair price." But that does not mean that the business is not unitary. In so arguing, appellant misconstrues the principle underlying the unitary concept. Use of the combined unitary method of computing income attributable to a particular state is not limited to those situations where the corporations have attempted to shift income from one place to another by manipulating intercompany sales prices. Rather, the apportionment method is used

whenever the various activities are dependent upon or contribute to each other and the success of the operation as a whole. In *Butler Bros. v. McColgan,* 315 U.S. 501, it was undisputed that, according to accepted accounting principles, the California portion of the business operated at a loss. Nevertheless, this Court held that since the business was unitary in nature, it was proper for California to measure its franchise tax by a portion of the overall net income.

C. Somewhat along the same line is appellant's argument that computing Chase's income from California sources by the combined unitary method violates the equal protection clause of the Fourteenth Amendment to the United States Constitution. The argument is based on the fact that independently owned fabricators are not combined with a copper producer. That contention is entirely specious. The equal protection clause does not require unequals to be treated equally. In truth and in fact, the only fabricators with which Chase competes that are equal to Chase are the fabricating subsidiaries of Anaconda and Phelps Dodge, the other two major copper producers in the United States. With respect to both Anaconda and Phelps Dodge, the Franchise Tax Board followed the combined unitary method. In the court below, appellant virtually admitted that Phelps Dodge and its fabricating subsidiary were unitary. We see no justification for a distinction between Chase and the fabricating subsidiary of Phelps Dodge.

D. Appellant claims that Chase and Kennecott Wire cannot be unitary with Kennecott because, appellant asserts, copper fabricators are not as profitable as copper producers. Such an argument was implicitly rejected by the decision of this Court in *Butler Bros. v. McColgan,* 315 U.S. 501. It was expressly rejected almost two decades ago by the

California Supreme Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal.2d 214, 238, P.2d 569, *appeal dismissed* 343 U.S. 939. Appellant's contention, if accepted, would mean that virtually no vertically structured enterprise could be unitary since almost any portion of a vertical process, if looked at separately, could be found to operate at a different profit ratio than another portion of the same business. For example, a large manufacturer of trucks may own the iron ore mines from which it acquires the iron from which is made the steel which is eventually fabricated into truck bodies. Should the iron mining portion of the business be singled out and treated as a separate business just because Value Line Investment Survey indicates, by some general average figures, that mining companies generally operate at a higher profit level than do manufacturing companies? We think not.

E. Appellant states as a fact that the Franchise Tax Board attributed seven times more income to Chase than Chase "actually earned." That is nothing more than a bootstrap argument which assumes the conclusion. Appellant begins with the assumption that Chase's books and records are inviolate and sacrosanct. Thus, according to appellant, any difference between the result of separate accounting and the result of the combined unitary method is "distortion." In other words, this is just a rehash of the argument that form, not substance, must control.

F. Appellant relies heavily upon *Norfolk & Western Ry. v. Missouri Tax Comm.,* 390 U.S. 317, stating that the case delivered two "messages" that were lost on the California Court of Appeal. The first so-called "message" was that the case restated the doctrine that even with respect to a unitary business a formula cannot be used which produces unrea-

sonable results in a particular case. That general principle, with which we agree, is of no aid to appellant here. In this case the Court of Appeal held that the four corporations were unitary and that, therefore, *a* formula should be used. Appellant's objections to the specific formula which was used by the Franchise Tax Board have not yet been decided by the California courts. The second "message" is that the Board cannot rely on a "generalized assumption of enhancement." Again, the principle has no application here. The question of whether a piece of property, such as a railroad car, can have a higher value because it is part of an operating system is not at all analogous to the question of whether four affiliated corporations are dependent upon and contribute to each other to the extent that it is proper to treat the activities of the group as a unitary business. The question of "enhancement" is not involved here at all.

G. In addition to its factual contentions, appellant makes two strictly legal arguments to the effect that use of the combined unitary method is *per se* unconstitutional. The first is that the unitary concept was designed by the Franchise Tax Board as a "guise" to "circumvent" Public Law 86-272. That argument is really incredible since Public Law 86-272 was not enacted until *three years after* the last year involved in this appeal. In any event, the combined unitary method does not operate so as to circumvent Public Law 86-272, which is merely a jurisdiction statute outlining the minimum "nexus" which a corporation must have with a state before the state has power to subject the corporation to an income tax. In the present case, California has not attempted to exercise jurisdiction over any corporation not doing business in California.

H. The second strictly legal argument is that, absent a sham situation, the combined unitary method can never be

used for franchise tax purposes. The argument is premised on the assumption that use of the combined method constitutes a disregard of corporate entities and a taxing of the franchises of corporations not doing business in California. That premise is false. Use of the combined method does not constitute an attempt to exercise jurisdiction over corporations not doing business in the taxing state. Rather, it is simply an accounting method used to determine the true amount of income attributable to the franchise which was, in fact, exercised within the state. See Rudolph, "State Taxation of Interstate Business: The Unitary Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, at 198.

IV. In the fourth section of our Argument, we will respond to the contentions made in the *amici curiae* brief filed jointly by the National Association of Manufacturers and the Committee on State Taxation of the Council of State Chambers of Commerce. We demonstrate here that *amici curiae's* brief is premised on a patently incorrect reading of the Court's decision in this case. Contrary to the statement in their brief, the California Court of Appeal did not find a unitary business existed ". . . on the sole ground that Kennecott owns controlling stock interest in Chase and the other Kennecott companies." Although there is absolutely no evidence of double taxation in this case, *amici curiae* state that there is a "burden upon national commerce" because there is some indication that Utah follows a different concept when computing Kennecott's income from Utah sources. We point out that even if there were a constitutional rule which required all states to follow the same accounting method (which there is not), that it is the Utah rule, not the California method, which is out of conformity with prior decisions of this Court.

V. In the fifth section we answer the contention of *amicus curiae* Financial Executives Institute, Inc., that the present decision is "blatantly discriminatory against multicorporate enterprises." We point out that it is not discriminatory to look to substance rather than form so that all interstate enterprises are taxed equally. To tax all multistate businesses the same, regardless of whether conducted in unicorporate or multicorporate form, is not discriminatory—it is fair, just, and reasonable.

VI. In the last section of our Argument, we point out that the matters of concern raised by *amicus curiae* Tax Executives, Inc., are more properly addressed to Congress. It may be true, as *amicus curiae* alleges, that there is a degree of "uncertainty." Such would seem to be a natural consequence of the fact that in our federal system the several states are allowed to develop, within constitutional limits, their own tax policies. There is no constitutional rule which requires the states to use the same rule with respect to use of the combined apportionment method just as there is no constitutional rule which requires the states to compute taxable income in the same manner and just as there is no constitutional rule which requires all the states to use precisely the same apportionment formula. The answers to the contentions of "uncertainty" lie in the Legislative, not judicial, realm. In that regard, we point out that there are bills currently pending in Congress touching upon these matters.

STATEMENT REGARDING THE FACTS AND EXTENT OF HEARING BELOW

Before beginning our argument, it is appropriate to comment upon appellant's statement of facts as well as certain insinuations made by appellant regarding the nature of the California Court of Appeal proceeding.

1. *Regarding the Facts.* The factual record in this case is voluminous. It consists of a lengthy stipulation of facts, a thick stack of exhibits and testimony of witnesses offered by appellant. Although the record is large, none of the facts are disputed. Since the facts are undisputed, the California Court of Appeal was presented solely with a question of law. Some of the numerous cases which so hold are cited in the Court's decision in this case. Accordingly, the so-called "findings" of the trial court which are merely mislabeled conclusions of law are not binding on appeal. Yet, it is these conclusionary statements of the trial judge upon which appellant relies most heavily. For example, on page 8, appellant quotes in full the statement of the trial judge to the effect that the apportionment formula operates to assign Kennecott's income to Chase. While treating such erroneous legal conclusions as undisputed facts tends to make appellant's job easier, it indicates that this Court should be careful not to accept as true appellant's conclusionary statements regarding the factual relationship that existed between Kennecott and its subsidiaries.

Although it had the option to do so, appellant did not have a record of all the facts prepared for this Court. Rather, appellant's jurisdictional statement stresses only those facts which tend to support the legal conclusion it seeks and ignores many undisputed facts which point the other way. Thus, appellant argues that the operations of Kennecott's fabricating subsidiaries in no way benefited Kennecott's income producing activities. But appellant fails to tell this Court that it is an undisputed fact that in 1958 the vice-president of Kennecott recommended that the Board of Directors of Kennecott approve the acquisition of yet another fabricator because, in the language of Kennecott's executive:

". . . the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper . . ." (Exhibit F)

See *United States v. Kennecott Copper Corporation,* 231 F.Supp. 95, affirmed 381 U.S. 414, wherein the acquisition of the fabricator was held to be a violation of the anti-trust laws. Again, with respect to its equal protection argument appellant would have this Court believe that Kennecott treated its fabricating subsidiaries the same as it treated independent fabricators. But appellant fails to state that the undisputed evidence shows that the president of Kennecott had a special assistant whose job was to assist the subsidiary companies with their engineering problems. (Exhibit B, page 20)

We will demonstrate that the facts actually before the California Court of Appeal support the Court's legal conclusions.

2. *As to the Hearing Below.* There is a thinly veiled insinuation throughout appellant's Jurisdictional Statement that because the opinion of the California Court of Appeal does not discuss each of appellant's contentions in detail, the Court did not really seriously consider appellant's arguments. Demonstrative evidence indicates that just the contrary is true. The usual time allotted for oral argument in the California Courts of Appeal is one hour. In this case, the Court initially set aside an entire afternoon for argument of this case. After that argument was concluded, the Court recognized that there were still additional questions and set aside yet another afternoon for argument. That virtually unprecedented action demonstrates that the Court of Appeal did not lightly reject appellant's arguments.

Along the same line, appellant suggests that the California Court of Appeal was just "rubber stamping" the

arguments made by the Attorney General as counsel for the Franchise Tax Board. Thus, on page 31, appellant refers to a character from the fantasy of Lewis Carroll and indicates its belief that the Court of Appeal accepted as true whatever we said three times. We do not have the power to mesmerize the courts that appellant suggests we have. In fact, the last important franchise tax cases before the California Supreme Court were decided in favor of the taxpayer. *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 34 Cal. Rptr. 545; *Honolulu Oil Corp. v. Franchise Tax Board*, 60 Cal. 2d 417, 34 Cal. Rptr. 552; *McDonnell Douglas Corp. v. Franchise Tax Board*, 69 Cal. 2d 506; 72 Cal. Rptr. 465. The last state tax case decided by the division of the California Court of Appeal which decided this case was decided in favor of the taxpayer. *Glass-Tite Industries, Inc. v. State Bd of Equalization*, 266 Cal. App. 2d 691, 72 Cal. Rptr. 244. However comforting appellant may find its rationalization, it is quite evident that the Court of Appeal ruled as it did because of the soundness of our legal arguments, not because of some hypnotic power which appellant imagines we have over the California courts.

ARGUMENT

I. In Computing Income From California Sources, California Follows the "Unitary Business" Concept

There is no national law which dictates the precise manner in which the states must allocate income for tax purposes. In our federal system, each state is allowed, subject to limitations imposed by the Constitution and the Congress in exercise of its powers, to adopt that method of computing income taxable in the state which best suits its particular needs. Because of the wide diversity of economic, political and business conditions that exist through-

out our nation, it is no wonder that there is no uniform approach to the taxation of income of corporations that do business in more than one state.[2] We believe that the California approach is the most logical. However, so that this Court can view in context the California method here challenged by appellant, it is appropriate to very briefly outline the various alternatives.

Essentially, there are two different accounting methods that can be used to determine the amount of operating income attributable to a corporation's activities in the state, namely, separate accounting and formula apportionment. Under the separate accounting method, consideration is given only to the gross income and expense items directly related to instate activities. Under this approach, a corporation could have net income in one state and losses in other states. Under the formula apportionment method, the net income of the entire operation is apportioned by formula between the various states in which the business is conducted. While there is no specific apportionment method required to be used by all states, the formula used most frequently is the three-factor formula of property, payroll and sales.

As indicated in the Willis Subcommittee Report, some states have a statutory preference for the separate accounting method whereas other states require the formula to be used in all cases. California does not fall into either of those extremes. California follows what has sometimes been referred to as the "unitary business" rule, whereby

---

2. The various methods of allocation and apportionment are described and discussed in detail in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88 Cong., 2d Sess., H.R. No. 1480, June 5, 1964, Vol. 1, Chap. 7, on "Division of Income," at 155-249. Hereinafter, this report will be referred to as the Willis Subcommittee Report.

the formula apportionment method is applied only to "unitary" businesses. Accordingly, if the activities of the taxpayer in the state are non-unitary in character, then the amount of income attributable to those activities is determined by the separate accounting method. On the other hand, if the California activities are just part of a unitary business conducted both within and without California, the amount of income attributable to the California portion of the business is determined by the formula apportionment method. This Court expressly upheld the California method in *Butler Bros. v. McColgan*, 315 U.S. 501.[3]

Determining the scope or boundaries of the unitary business to which the formula is to be applied is not always easy and is a problem to which not all states have given the same solution. Not all business operations, particularly in this age of mergers and acquisitions, are as straightforward as in the *Butler Bros.* case. In *Butler Bros.*, the operations there held to be unitary were all conducted within the framework of a single corporate entity. Moreover, that corporate entity conducted no business operations in addition to those considered in the case. There are literally thousands of situations, however, where the boundaries of the unitary business and the corporate entity are not coterminous. There are numerous conglomerates that operate several distinct businesses within one corporate entity. On the other hand, there are numerous examples of a single business operation conducted by a group of affiliated corporations.

---

3. The rule is applied consistently by California, regardless of whether the effect is to raise the amount of income attributable to California sources, as in *Butler Bros.*, or to lower the amount of income attributable to California sources, as in *Superior Oil Co. v. Franchise Tax Bd.*, 60 Cal. 2d 406, 34 Cal. Rptr. 545, and *Honolulu Oil Corp. v. Franchise Tax Bd.*, 60 Cal. 2d 417, 34 Cal. Rptr. 552.

There are those states that, rather than attempting to solve the problem, simply let form control. Thus, all the income of a single corporation must be apportioned by a single apportionment formula, regardless of how unrelated the activities of the various corporate divisions might be. On the other hand, the combined apportionment method is never used, regardless of how dependent the corporation's activities are with those of affiliated corporations.

Again, California does not take this simple, but extreme, approach. California believes that, in conformity with the decision of this Court in *Butler Bros. v. McColgan, supra*, it is the income of a unitary business which should be apportioned by formula, regardless of the form in which that business is conducted. For example, assume a conglomerate had one division that produced and distributed motion pictures, another division which manufactured and sold pharmaceutical products and yet another division which conducted aerospace research for the federal government. California would treat each division as a separate business and apportion the income of each business between the states in which such business was conducted. Likewise, if a parent corporation and its subsidiaries were engaged in a single unitary business, California would compute the amount of income attributable to California sources by applying an apportionment formula to the net income of the entire business.

Thus, in administering the California franchise tax, the Franchise Tax Board stresses substance over form and applies the unitary concept to all unitary businesses, regardless of the form in which that business is conducted. We believe that this approach is logical and rational. We know of no decision of this Court which even hints that this approach is unconstitutional.

In that regard, it is appropriate to note that application of the combined unitary method to unitary businesses conducted in multicorporate form is nothing new or novel. It has been followed in California since the early years of the California franchise tax, which was originally enacted in 1929. Since the inception of the franchise tax, use of the combined unitary method, *per se*, has been challenged in the courts only once, in addition to the instant case. That was the case of *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16, which dealt with the income years 1936 and 1937. In *Edison Stores*, the California Supreme Court rejected the argument that use of the combined unitary method resulted in taxing extraterritorial values and held that such method was authorized by statute and was consistent with constitional principles. The Court stated:

> "However, accepting as we must, the application of the law to unincorporated wholly-controlled branches or businesses located in other jurisdictions as set forth in *Butler Bros. v. McColgan*, 17 Cal. 2d 664 [111 P.2d 334], 315 U.S. 501, the conclusion is irresistible that the same rule should apply to incorporated wholly-controlled branches or businesses so located." 30 Cal. 2d 472, 473-4; 183 P.2d 16, 17.

The fact that in four decades only one other taxpayer has challenged the use of the combined unitary method *per se* is strong evidence that taxpayers generally feel that such method is proper, constitutional, and generally productive of the correct result.[4] As stated by Justice Cardoza in *Coler v. Corn Exchange Bank*, 250 N.Y. 136; 164 N.E. 882, 884.

> "Not lightly vacated is the verdict of quiescent years."

---

4. At the present time, California uses the combined unitary method with respect to eight to ten thousand corporations annually.

Moreover, throughout the years various legal writers have commented upon the combined unitary method and recognized it as a proper method of computing income. See, for example, Altman & Keesling, *Allocation of Income in State Taxation*, 2d ed (1950), pp. 169-178; Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42, 57; Hellerstein, "Recent Developments in State Tax Apportionment and Circumscription of Unitary Business," 21 National Tax Journal 487; Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, 194. We know of no writer who has suggested that use of the combined unitary method is *per se* unconstitutional.

We submit that it cannot be seriously disputed that if a parent corporation and its wholly-owned subsidiaries are engaged in a unitary business within and without California, the Franchise Tax Board may properly determine the amount of income attributable to California sources by the combined unitary method.

II. The Activities of Kennecott, Kennecott Sales, Chase and Kennecott Wire Constitute a Unitary Business

It takes only a moment's reflection to realize that the question of what constitutes a unitary business cannot be answered by a simple checklist of objective facts. The range of business relationships is far too varied. Some unitary businesses are horizontally structured enterprises, such as in *Butler Bros. v. McColgan*, 315 U.S. 501. Other unitary businesses are vertically structured enterprises, such as in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113. Yet other unitary businesses are such because of strong central management, common financing and cen-

tralized departments which handle such matters as accounting and insurance which tie together otherwise operationally independent divisions, such as in *General Motors Corp. v. District of Columbia*, 380 U.S. 553. It is readily apparent that the type of fact which indicates that a horizontally structured business is unitary, such as centralized purchasing of a product sold by all branches, will ordinarily not be present in a vertically structured business. Therefore, a general test is needed.

A succinct statement of the general rule which has consistently been followed by the California courts and which was followed by the California Court of Appeal in the instant case was made by the California Supreme Court in *Edison California Stores v. McColgan*, 30 Cal. 2d 472, at 481; 183 P.2d 16, at 21,

> "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; . . ."

Surely that statement captures the essence of the rule. The unitary principle applies and formula apportionment is proper when the activities of one member of the affiliated group are dependent upon or contribute to the activities of the other corporations and the success of the group as a whole.

It cannot seriously be denied that the test of mutual contribution and dependence is fully satisfied in this case. Kennecott and its subsidiaries present a clear-cut example of a vertically structured manufacturing and selling business which by its very nature constitutes a unitary business.

As a group, Kennecott and its copper selling and fabricating subsidiaries are engaged in various phases of the copper business, from mine to consumer. Kennecott mines,

concentrates, smelts and refines the copper ore. Chase and Kennecott Wire take refined copper and convert it into consumer products. Surely the entire operation is a unitary business. To contend that the fabricating operations of Chase and Kennecott Wire are truly independent businesses is equivalent to contending that the assembly plant operations of General Motors constitute a separate business. The contention would be preposterous.

The dependence of Chase and Kennecott Wire upon Kennecott is undisputed. There are only three large producers of refined copper in the United States—Kennecott, Anaconda and Phelps Dodge. Undisputed testimony proved that Anaconda and Phelps Dodge sell most, if not all, their refined copper to their fabricating subsidiaries. Thus, if Chase and Kennecott Wire were to acquire refined copper, their basic raw material, at a competitive price, it had to come from Kennecott. During the period involved in this litigation, the only other source of domestic copper was the "custom smelters", whose price was higher.

Chase and Kennecott Wire, on the other hand, contributed to the success of Kennecott. Appellant's attempt to have this Court treat the activities of Chase as a separate business in which Kennecott has no interest other than that of a shareholder who has invested some idle funds completely overlooks the history and structure of the copper industry. It is not possible to brush off Chase's reliance on Kennecott and Kennecott's use of Chase as nothing more than mere market place encounters of an independent buyer and seller. It is certainly not appropriate here to go into detail on all the economic advantages realized by a mining company which controls a fabricating subsidiary or how the ownership of a fabricator aids the mining parent in its attempt to control and stabilize the price of the

metals market. We can, however, point to a couple of documents which reveal that Kennecott's interest in Chase and Kennecott Wire has been, and still is, much more than that of a mere stockholder.

We refer first to the *Report of the Federal Trade Commission on the Copper Industry*, published by the Government Printing Office in 1947. The Federal Trade Commission Report demonstrates, both by general approach and specific statement, that Kennecott's interest in Chase was more than that of a mere stockholder. Thus, the report begins by stating that copper production includes four major functional operations: mining, smelting, refining *and fabricating*. FTC Report, pp. 7-8. After discussing who controls the different phases of copper production, that portion of the report concludes by stating:

> "It is apparent from the foregoing that in the United States the copper industry is closely controlled from the mining of the copper down to the point where the finished copper products are embodied in consumer goods. Four groups, Anaconda, Kennecott, Phelps-Dodge, and American Smelting & Refining Co., dominate this business." FTC Report, p. 55.

Thus, it is apparent that the FTC would deny that, for its purposes at least, Chase and Kennecott were not simply parts of one large business.

The FTC Report also reveals that the controlled fabricators were not then treated the same as the independent fabricators. The report notes the reported fact that in 1937 General Cable and Revere were unable to secure enough copper to meet their needs and that each company had to turn away substantial business. It was contended that during the same period the fabricators owned by Kennecott had not turned down any orders. FTC report, pp. 79-80. It is then stated:

"The situation which now confronts General Cable Corp. and Revere Copper & Brass Co., Inc.—and all nonintegrated buyers of raw copper—is even worse than it was in 1937." FTC report, p. 80.

Later, speaking of the so-called "open market" for copper, the report states:

"It is difficult to see how a really independent and truly competitive open market in copper can exist with three companies, Anaconda, Phelps-Dodge, and Kennecott, producing more than 80 percent of the primary copper, and with foreign copper barred from competition by the 4-cent duty. Furthermore, the fabricators integrated with the 'big three' have first call on the copper produced by their mining operations and their requirements are heavy." FTC report, p. 83.

Addressing itself specifically to Kennecott's acquisition of Chase, the report states:

"Thus Chase Companies, Inc., was engaged directly or through subsidiaries, in the manufacture and sale of a variety of copper and brass products and other products, controlled a chain of distributive warehouses, and also controlled an abundant water supply for use in its manufacturing operations. Acquisition of its control by Kennecott Copper Corp. in May, 1929, enabled the latter to extend its field of operations from the mere mining of copper ores and production of raw copper into the fabrication of copper and brass products and, incidentally, to assure itself of a demand for a portion of its raw copper output." FTC report, p. 414.

It is quite obvious, therefore, that at the time of the publication of the FTC report in 1947 the relationship of Chase and Kennecott was much deeper than that of a buyer and seller which happened to meet in an independent market place. That this vital relationship between copper pro-

ducer and copper fabricator continued throughout the years here involved (1954-1956) is vividly displayed by Kennecott's attempt to acquire the Okonite Company. Following a study of Kennecott's position in the copper market, in 1958 Frank R. Milliken, then a vice-president of Kennecott, submitted a memorandum entitled "Acquisition of the Okonite Company" to the Board of Directors of Kennecott. The memorandum states in part:

> "It is recommended that Kennecott acquire The Okonite Company, producers of insulated wire and cable, because the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper and will also provide a second profit on copper produced." (Exhibit F)

The FTC report also reveals that one of the prime objectives of the copper oligopoly throughout the history of the copper industry has been to stabilize the price of domestic copper at a level which will bring a healthy return to the copper producers. To effect the desired result, the large producers have over the years employed numerous devices, including export pools and international cartels. See FTC report, pp. 183-254. A recent economic essay indicates that the ownership and control of fabricating subsidiaries has aided the "Big Three" (Kennecott, Anaconda, and Phelps-Dodge) in their efforts to stabilize and control the copper market and copper prices. James L. McCarthy, "The American Copper Industry, 1947-55," *Yale Economic Essays* (Spring 1964), states:

> "The prime source of economic power in the copper industry has been the control of relatively high quality and extensive ore bodies, augmented by forward integration through fabrication." McCarthy, p. 68.

The McCarthy article also indicates less obvious ways in which the integrated producer-fabricator has an advantage

over the truly independent firms. One such factor is that the integrated producer can control the nature of the work of the fabricator. Fabricators are not all alike. Some use relatively more new copper than others. "Similarly, much of Chase Brass and Copper's output is oriented to brass mill products of high (new) copper content to absorb the output of the parent firm Kennecott, . . ." McCarthy, p. 72, fn. 1.

The overall operations of the integrated producer-fabricator are not as drastically effected by changes in refined copper prices as are the operations of an independent fabricator. As pointed out by McCarthy, the fabricators, primarily the independents, have tended to speculate in copper prices. Thus, if a price rise in primary copper was expected, the fabricator would attempt to build up his inventory of new copper. Likewise, if copper prices were expected to decline, they would reduce their surplus inventory. McCarthy, pp. 76-77, 89-91. The integrated producer-fabricator would not, of course, be as concerned with these "windfall" profits and losses to the fabricator since any profit (or loss) to the fabricator would be offset by an equivalent loss (or profit) to the producer.

It is submitted that each of the members of the Kennecott family of corporations involved in this case played a vital role in the copper business owned and controlled by Kennecott. Chase and Kennecott Wire both played significant parts in that unitary business.

In its Jurisdictional Statement, appellant all but ignores these overwhelming facts showing contribution and dependency. Rather, appellant concentrates on the significant, but less important, factors such as common insurance programs, executive control of salaries, etc. In doing so, appellant does a disservice to the Franchise Tax Board and to the opinion of the California Court of Appeal. The

Franchise Tax Board did not use the combined unitary approach in this case just because there was some common insurance plus some contacts at the administrative level. The Board's determination was based essentially on the fact that Chase and Kennecott Wire were dependent upon Kennecott for their basic raw material. The facts discussed by appellant are merely supplemental and give further proof of the unitary nature of the business. They are not the touchstone of the Board's determination. For example, if Chase were not in the copper fabricating business but did nothing more than produce motion pictures for television, the Board would not have used the combined unitary method, regardless of the fact that some common insurance programs existed. In any event, appellant's tactic of looking at isolated facts individually is erroneous. Common insurance plans, for example, may not in and of themselves prove a unitary business exists. But such plans, together with other facts may, as they do here, complete the picture of an overall unitary operation.

III. The Facts Relied Upon by Appellant Are Not Persuasive. Appellant's Legal Arguments Are Unsupportable.

In the California Court of Appeal appellant's brief was over 250 pages long. Appellant has attempted to cram most of the arguments from that brief into its 39 page Jurisdictional Statement. However, in doing so appellant has so confused and jumbled up the contentions that it is difficult to determine just what appellant is arguing, other than it does not want Chase's income computed by the combined unity method. In this section we shall attempt to pick out the facts and legal contentions relied upon most heavily by appellant and demonstrate the errors in appellant's position.

A. THE FACT THAT CHASE, KENNECOTT WIRE AND KENNECOTT SALES ARE SEPARATELY INCORPORATED IS NOT DETERMINATIVE.

Appellant appears to lay great stress upon the fact that Chase is separately incorporated.[5] Appellant's reliance upon that fact is misplaced. As demonstrated earlier, the unitary concept applies to all corporate activities that are tied together by mutual contribution and dependence. For decades the Franchise Tax Board has applied the rule based on the substance of the activities in question rather than by the form in which the activities are carried on.

To have determinations based on substance rather than form is just plain good common sense. While some states might elect to be bound by form, surely there is nothing in the United States Constitution that would require California to recognize form over substance. There is no constitutional principle which guarantees corporations the right to change their state tax consequences merely by changing the form in which they do business. In *Helvering v. Lazarus & Co.*, 308 U.S. 252, this Court, in holding that a sale and lease back of real property was in reality a mortgage, stated, at page 255,

> "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, . . ."

Suppose that Kennecott, as sole shareholder of Chase, Kennecott Wire and Kennecott Sales, elected to reorganize and merge each of the subsidiaries into Kennecott. It could do so very easily without any material alteration in operational practice. Any changes would be merely formal. For example, the title of the individual who is the head of

---

5. Appellant's reliance on that fact is confusing since appellant virtually concedes that Chase is unitary with Kennecott Wire and yet they are both separate corporate entities.

Chase would be changed from "President" of Chase to, possibly, "Vice President: Chase Division" of Kennecott. If such a merger did occur, then Kennecott itself would be doing business in California and no one would seriously question the right of California to compute the measure of its franchise tax by applying an apportionment formula to the net income of the corporation. A different result should not be reached simply because Kennecott has certain portions of its business conducted by wholly-owned subsidiaries rather than by divisions of the parent company.

B. THE FACT THAT KENNECOTT ALSO SOLD SUBSTANTIAL AMOUNTS OF REFINED COPPER TO INDEPENDENT FABRICATORS DOES NOT MEAN THAT KENNECOTT IS NOT UNITARY WITH CHASE AND KENNECOTT WIRE

In addition to supplying Chase and Kennecott Wire, Kennecott also sold refined copper to independent fabricators. The evidence indicates that Kennecott sold to its subsidiaries and the independents at the same price and that in times of copper shortages it sold to the subsidiaries and independents on an allocation basis. Appellant feels this forecloses the use of the combined unitary method. We do not agree. Appellant's argument is nothing more than an attempt to have this Court accept the "fair price" standard—an argument necessarily rejected by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501.

Initially, we note that careful analysis reveals that the copper allocation method used by Kennecott is not as fair as appellant would imply. The copper allocation method used by Kennecott has an advantage for Chase and Kennecott Wire which is inherent in the manner the allocation is made. Let us explain. When Kennecott entered a period when demands for its copper exceeded its supply, the copper was allocated to the various fabricators based on percentages determined from a test period. Thus, if during

the test period, Chase had purchased 20% of Kennecott's copper, it would get 20% of Kennecott's copper during the allocation period. Naturally, the test period would have to be a period prior to the shortage period, i.e., a period of over-supply. During a period of over-supply of primary copper it would be only natural (and there is no evidence to contradict the normal inference) that Chase and Kennecott Wire would be buying relatively more of their copper needs from Kennecott than would a truly independent fabricator. This would seem to follow from the fact that during times of over-supply the custom smelter price for primary copper is lower than the "producer's price." Thus, since we would assume that an independent fabricator would always attempt to buy its raw material at the lowest possible price, during a period of over-supply independent fabricators would buy from Kennecott (and pay the higher "producers' price") only after exhausting the supply of copper from the custom smelters. On the other hand, there is absolutely no evidence to indicate that Chase refused to purchase first from its parent during times of over-supply, ie, there is no evidence that Chase would acquire copper from a competitor of Kennecott at a time when Kennecott had surplus copper it was trying to sell. Thus, it would appear that Chase and Kennecott Wire would automatically be in a good position relative to the independent fabricators during any normal test period. Accordingly, this Court should not attribute any legal magic to the fact that during periods of copper shortage, sales were made on the allocation formula devised by Kennecott.[6]

---

6. Apparently not all independent fabricators believe that Kennecott treats independents and Chase equally. At least two independent fabricators have filed anti-trust actions in the federal district court in Philadelphia alleging that the practices of the major copper producers, including Kennecott, give an unfair competitive advantage to the captive fabricating subsidiaries. See *New York Times*, November 5, 1970, page 71, 82.

The fact that Kennecott sold copper to independent fabricators at the same price it sold to its subsidiaries does not mean that the business was not unitary.[7] It certainly does not disprove the mutual contribution and dependance which we have shown existed. At the very most, it shows that Chase acquired copper from its parent at a "fair price".

This Court, however, in *Butler Bros. v. McColgan,* 315 U.S. 501, necessarily rejected the concept of separate accounting based on a "fair price" standard. In *Butler Bros.,* the California portion of the business showed a loss by accepted accounting principles. There was no contention that the price charged the California store was unfair or unreasonable. In fact, goods were charged to the California store *at cost, i.e.,* the price really could not have been fairer. Yet this Court held that since the operations were unitary in nature, it was proper for California to measure its franchise tax by a fairly apportioned part of the net income of the whole operation.

It does not take much imagination to visualize the tax shifting that would occur if this Court held that Chase was not unitary with Kennecott just because Kennecott sold some copper to outsiders at the same price it sold to Chase. For example, under current standards, General Motors Corporation is a typical unitary business. See *General Motors Corp. v. District of Columbia,* 380 U.S. 553. General Motors has an assembly plant at Fremont, California, to which parts and components are shipped for assembly into automobiles. Undoubtedly, General Motors sells identical parts and components to independent dealers and retailers for resale as replacement parts. Should the assembly plant

---

7. As pointed out by the California Court of Appeal, to discriminate in pricing would have been a violation of the Robinson-Patman Act (15 U.S.C. § 13a).

be treated as a separate business? We think not. Yet that would probably be the result of accepting appellant's position. Likewise, there are several large unitary oil companies that are integrated from oil exploration down to operating gasoline service stations. Should the service station portion of the business be isolated and treated separately just because the company sells gasoline to independent service station operators? Large soft drink manufacturers sell their syrup to wholly owned bottling companies which distribute the cola. Should the bottling operations be isolated and treated as a separate business just because the parent also sells syrup to independently owned bottling companies? Again, we think not. The service station operations of the oil companies and the bottling operations of the soft drink company contribute to the success of their parents much more than merely providing a market for their products.

C. CHASE HAS NOT BEEN DISCRIMINATED AGAINST

Appellant asserts that it is being denied equal protection of the laws in violation of the Fourteenth Amendment to the United States Constitution. The argument is based on the allegation that California is treating appellant differently than some of appellant's competitors. That argument is unsupportable.

The Equal Protection clause of the Fourteenth Amendment simply requires, in general terms, that equals be treated equally. That is exactly what the Franchise Tax Board has done. Undoubtedly the American Brass Company (a wholly-owned subsidiary of Anaconda Copper Company) and Phelps-Dodge Copper Products Corporation (a wholly-owned subsidiary of Phelps-Dodge Copper Corporation) are major competitors of Chase. In each case

the Franchise Tax Board has determined that those fabricating subsidiaries are unitary with their parent corporation, and has computed the income of the subsidiary by the combined report approach.[8]

Appellant appears to find discrimination in the fact that an independent fabricator not related to a copper producer is not combined with a copper producer for tax computation purposes. However, since appellant is engaged in a unitary business with other members of the Kennecott group of corporations, it is not equivalent to a fabricator which is independent of any copper producer. The Equal Protection Clause does not require that unequals be treated equally. An independent corporation operating a retail shoe store in California would determine its net income by reference solely to its own books and accounts. However, a competitor shoe store, separately incorporated but a part of a unitary group, must compute its net income by the combined report approach. *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P. 2d 16. Likewise, an independent corporation engaged in business as a jobber of tractors and tractor parts would compute its income by reference only to its own books. On the other hand, a competitor jobber, separately incorporated but part of a unitary business, must compute its net income by the combined report approach. *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal. 2d 214, 238 P.2d 569, appeal dism'd 343 U.S. 939.

---

8. It appears that Anaconda considers its fabricating activities to be a part of its copper business. In the September 14, 1970, issue of Newsweek, pages 70-1, there is a full two-page ad picturing fabricated copper products produced by Anaconda. The ad states, in part, "Anaconda, the mining company, is also Anaconda, the manufacturer.

Half of our business is fabricating metals into the countless items our economy demands."

It hardly lies in appellant's mouth to state that there is no economic difference between integrated and non-integrated fabricators. If appellant's present statements in that regard are correct, why did Kennecott feel it necessary to actively go out and acquire the Okonite Company, a previously independent fabricator? Why, if there is no real economic difference, did the federal courts find it necessary to order Kennecott to divest its acquisition of Okonite? *United States v. Kennecott Copper Corporation*, 231 F.Supp. 95, affirmed 381 U.S. 414.

B. A GROUP OF RELATED CORPORATIONS CAN COMPRISE A UNITARY BUSINESS EVEN THOUGH THE DIFFERENT CORPORATE MEMBERS OF THE GROUP PERFORM DIFFERENT FUNCTIONS

Appellant asserts that the Kennecott family of corporations (particularly Chase and Kennecott) should not be considered a unitary business because each corporation performs a different function. The contention is tied in with the fact that *Value Line Investment Survey* states that, in general, mining companies make more money than fabricating companies. That contention is patently unacceptable for it would result in no vertically integrated business being unitary.

Such a result would be contrary in principle to the decision in *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal.2d 214, 238 P.2d 569, appeal dism'd 343 U.S. 939. The *John Deere* case involved a parent and eighty-four subsidiary corporations which were involved in the integrated business of manufacturing and selling farm equipment, with operations extending from the purchase of raw materials to the distribution of the finished products. Within that multi-corporate framework, each corporation performed its own unique function—some operated manufacturing plants, others sold the products at the wholesale or retail

level. The taxpayer in the *John Deere* case was one of the subsidiary corporations and was the only member of the group which did business in California. Its sole function was to buy the finished products from the parent corporation and sell them to various retail outlets, i.e., it was what is commonly known as a "jobber."

Yet the taxpayer, represented by the same counsel that represent the taxpayer in this case, conceded that the entire group comprisd a single unitary business—despite the fact that the activities of the taxpayer there ("jobbing") were quite unique and different from the activities of some of the other corporate members of the Deere group (manufacturing, for example). Surely, then, appellant is not serious in suggesting that the Kennecott group cannot be considered a unitary business for the sole reason that each corporate member of the group performed a different function in the overall business operation.

Along that same line, appellant states, based on a *Value Line Investment Survey* report, that the fabrication business is not as profitable, on the average, as is the mining business. Accordingly, appellant contends, the fabrication function should not be considered unitary with the mining function. Actually, that argument is nothing more than a rehash of the argument rejected by the Court in the *John Deere* case.

In *John Deere* the taxpayer argued that the income from the California portion of the business should not be computed by formula apportionment because, as it had proved by reliable evidence, the California operations were not conducted as profitably as were the operations outside California. The California Supreme Court responded,

> "But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in

the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable values. (*Butler Brothers v. McColgan, supra,* 17 Cal.2d 664, 667-668; *Edison California Stores, Inc. v. McColgan, supra,* 30 Cal.2d 472, 477-479; *El Dorado Oil Work v. McColgan, supra,* 34 Cal.2d 731, 735.) As above stated, here the overall organization of Deere and Company was a manufacturing and selling business having its operations extending into a number of different states and providing an example of a typical unitary business subject to formula allocation as a reasonable method of apportionment for franchise tax purposes. (*Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 [41 S. Ct. 45, 65 L.Ed. 165]; *Bass, Ratcliff & Gretton, Ltd. v. State Tax Com.,* 226 U.S. 271 [45 S.Ct. 82, 69 L.Ed 282]; *North American Cement Corp. v. Graves,* 299 U.S. 517 [57 S.Ct. 311, 81 L.Ed. 381]; *International Harvester Co. v. Evatt,* 329 U.S. 416 [67 S.Ct. 444, 91 L.Ed. 390].) The fact that the taxpayer may show that according to a separate accounting system, the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a method of apportionment of the unitary income. (*Ibid.*) The only requirement is that the formula used be not intrinsically arbitrary or produce an unreasonable result." 38 Cal.2d 223-4; 238 P.2d 573-4.

Moreover, the *Value Line Investment Survey* figures cited by appellant really do not support the factual conclusions

drawn by appellant and illustrate the danger involved in attempting to draw specific factual determinations from general data. In the first place, we note that the figures discussed by appellant are industry-wide averages for a three year period. They do not take into account the wide divergence of profits between the various firms which make up the industry. For example, appellant states that the mining companies earned 34.1% profit. Yet the data from which that figure was computed shows that American Zinc Corporation earned only 7.5% in 1954 whereas the Campbell Red Lake Company earned 57.4% in 1955.

In the second place, the *Value Line* survey does not treat Chase and Kennecott Wire the same as independent fabricators. To the contrary, *Value Line* finds it appropriate to treat Kennecott, Chase, Kennecott Wire and the other Kennecott subsidiaries as comprising a single business whose total operating income is most accurately determined as a group.

It is submitted that appellant is not aided by the fact that the various corporate members of the Kennecott group performed different functions or the fact that *Value Line Investment Survey* reports that mining companies generally make more profits than fabricating companies.

E. THE FRANCHISE TAX BOARD DID NOT ATTRIBUTE TO CHASE SEVEN TIMES MORE INCOME THAN CHASE ACTUALLY EARNED

Appellant states as a matter of fact, that the Franchise Tax Board multiplied Chase's "actual corporate income" seven times. Actually, the Board made no such computation at all. Recognizing this, appellant has a lengthy appendix wherein it attempts to prove by algebraic formula that the Board somehow indirectly recomputed Chase's total net income. However, the audit workpapers showing how the

assessments in this case were computed demonstrate that the Board at no time purported to determine how much income was attributable to Chase's activities outside California. There would be no need to make any such computation since it would be completely irrelevant to the combined unitary method. Determining how much income the formula would attribute to Chase's activities outside California would no more be relevant in this case than it would be to determine, for example, how much the formula would attribute to one of the six out-of-state outlets in *Butler Bros. v. McColgan, supra.*

But, in any event, the assertion that the formula attributed more income to Chase than Chase actually earned is based on the erroneous legal premise that for tax purposes a corporation actually earned only that amount of net income reflected by the separate books and records of the corporation. In other words, appellant's statement is based on the premise that as a matter of law the separate books and records of a separate corporate entity are sacrosanct. That premise was rejected by the California Supreme Court in *Edison California Stores v. McColgan,* 30 Cal.2d 472, 183 P.2d 16. In that case the taxpayer had computed its tax based on its separate corporate books and records. The Board, however, computed the tax by the formula apportionment method. This raised the tax for the year 1936 from $2,731.99 to $7,893.08 (nearly three times) and for the year 1937 from $712.34 to $7,025.69 (nearly ten times). Since the California franchise tax is measured by the amount of net income attributable to California sources, the Court was necessarily holding that the formula determined the amount of income actually earned by the taxpayer in California for tax purposes. In support of its conclusion, the Court relied on its opinion in *Butler Brothers v.*

McColgan, 17 Cal.2d 664, 111 P.2d 334, in which the taxpayer's separate accounting system showed a *loss* due to its California activities of $82,851, whereas the formula determined a $93,500 *profit* was "actually earned" in California. This increased the California tax from the minimum tax of $25 to $3,798.43 (over 150 times). This Court, in upholding the assessment against *Butler Brothers,* noted that the taxpayer had computed the loss in California according to "recognized accounting principles" (315 U.S., 505) and stated:

> "It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121, that a State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission, supra,* p. 283. In either aspect of the matter, the results of the accounting system employed by appellant do not im-

peach the validity or propriety of the formula which California has applied here." 315 U.S., 507-8.

In summary, appellant's statement that the Board assigned seven times more income to Chase than Chase actually earned is based on the premise that Chase's separate corporate books, and only Chase's separate books, reflect the amount actually earned in California by Chase. To the extent the formula produces a higher figure, appellant states, the State has attributed to Chase income actually earned by another corporation. But the decided cases demonstrate that appellant's premise is false. If a business is unitary, the amount of income actually earned by the portion of the business done in California must be determined by formula apportionment, and the taxpayer cannot impeach that result by showing that its separate books, maintained according to accepted accounting principles, show a different figure.

F. APPELLANT'S RELIANCE ON NORFOLK & WESTERN RY. V. MISSOURI TAX COMM., 390 U.S. 317, IS MISPLACED

The one legal decision relied on more than any other by appellant is *Norfolk & Western Ry. v. Missouri Tax Comm.*, 390 U.S. 317. Appellant asserts that the "messages" of the case were lost on the California Court of Appeal. We submit, however, that a close reading of the case reveals that appellant's reliance is misplaced.

The *Norfolk & Western* case did not involve the proper methods of taxing the income of a multistate business. Rather, the question presented involved determining the value of railroad rolling stock in the State of Missouri on tax day for ad valorem property tax purposes. Missouri arrived at the assessment of rolling stock by first determining the value of all rolling stock of the railroad regardless

of where located. That figure ($513,309,877) and the method of its derivation were not in issue. Missouri next determined the percentage of track of the railroad system located in that state and applied that percentage (8.2824%) to the total value of the rolling stock to arrive at the assessed valuation of rolling stock in Missouri. This method proceeded on the assumption that as a matter of fact on tax lien day the rolling stock of the railroad was evenly distributed throughout the railroad's system. That factual assumption was proven to be false because the railroad was able to show by actual inventory count the rolling stock in Missouri on tax day. The railroad, using the same valuation method as the state but determining the value of its rolling stock in Missouri by reference to the actual inventory count, determined that the proper assessed value was approximately $7,600,000, while the factual assumption adopted by Missouri yielded an assessed value of $19,981,000. Since there was no dispute as to the total value of all the railroad's rolling stock, the only matter to be determined by the Tax Commission was how much of that rolling stock was in Missouri on tax lien day. It is quite obvious that this Court correctly determined that the Tax Commission had miscalculated. It was as if the Tax Commission had said, "Mr. Railroad, I have determined that on tax lien day you had 100 railroad cars in Missouri," and the railroad was able to show by actual count that it had only 75 cars in Missouri on that day.

It is also clear from the opinion why this Court could not sustain the assessment based on any theory of "enhanced" value. Property within a state may have an "enhanced" or "going concern" value that is greater than its value when considered separately. The "enhanced" or "going concern" value attaches to the entire property, con-

sidered as a unit. But the Tax Commission was clearly foreclosed from making any such "enhancement" argument on the record in the *Norfolk & Western* case since it had found that the total value of all the rolling stock was $513,309,877. The finding that such was the total value of the rolling stock necessarily included one of two alternative implied findings—(1) that there was no "enhanced" value or (2) that the $513,309,877 figure included its "enhanced" value. In other words, a conclusion that the assessment could be sustained on an "enhanced" value theory would necessarily require a challenge to the conclusion that the $513,309,877 total value figure was correct—a fact which was not in dispute in the case. Moreover, as noted by this Court, the Tax Commission did not rely on any "enhanced" value theory either in making the assessment or when defending the assessment before the Missouri Supreme Court. 390 U.S., 323.

The Franchise Tax Board did not proceed on the theory that it has the right to "enhance" the income of Chase. During the years here involved, Chase was engaged in income producing activities in California. The major issue presented in this litigation is whether those activities were, as appellant alleges, the activities of a separate corporation engaged in a separate business or whether, as we contend, it was simply a part of a large copper business. If appellant is correct, i.e., if Chase was engaged in a truly independent business which in no way contributed to or was dependent upon the activities of any of its related corporations, then the California income of Chase is properly determined by allocating to California a portion of the income of the corporation as determined from its separate books of account. If, on the other hand, we are correct, i.e., if Chase is really just part of the larger Kenne-

cott copper enterprise, then the California income produced by the California activities must be determined by allocating to California a portion of the income of the entire business. Obviously, this is not at all analogous to saying that a particular item of tangible property, such as a railroad car, has an "enhanced" or "going-concern" value because it is operated as a part of a train.[9]

There were no "messages" in the *Norfolk & Western* case that were "lost" on the California Court of Appeal.

G. P.L. 86-272 DOES NOT PROHIBIT COMBINED REPORTING

Appellant states that California's use of the combined unitary method is just a "guise" devised to "circumvent" P.L. 86-272. That argument is really incredible. We do not see how appellant can seriously suggest that the combined unitary concept, which has been followed by California since the 1930's, was devised by the Board as a "guise" to "circumvent" a statute which was enacted in 1959.

---

9. In fact, the unitary approach to income determination may actually produce a *lower* California tax. This would certainly occur if the total net income of the group was less than the income of the separate entity which did business in California, which might well result if some members of the group had operating losses. Moreover, the unitary approach could produce a lower California income even when the total income of the group was higher than the income of the separate corporation doing business in California. This is so since under the unitary approach the apportionment formula percentage is much smaller. For example, if Chase were a completely independent business operation, the numerator of the payroll factor of the apportionment formula would be Chase's California payroll and the denominator would be Chase's total payroll. Under the unitary approach, the numerator of the payroll factor would still be Chase's California payroll but the denominator becomes the payroll of the entire unitary business. In other words, under the unitary approach, the State measures its tax by a smaller percentage of a larger net income. This may or may not apportion more income to California. That clearly indicates that the Board is not proceeding on an "enhancement" theory.

In any event, there is nothing in the language of P.L. 86-272 itself or in the history leading to its enactment to indicate that Congress intended to prohibit use of the combined unitary method and, in effect, require the individual states to base their tax computations on form rather than substance. P.L. 86-272 was a "stop-gap" measure enacted in 1959 (three years after the last year involved in this litigation) designed to overrule the decision of this Court in *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, which had been decided by this Court earlier that same year. See Willis Subcommittee Report, vol. 1, pp. 7-8.

The statute in no way purports to deal with the area of income computation or accounting methods. To the contrary, the statute is jurisdictional in nature, i.e., it describes the minimum contacts or "nexus" that must exist between a State and a corporation before the State could have "power" (i.e., jurisdiction) over the corporation to impose a net income tax. California has not attempted to impose its franchise tax on any corporation over which it does not have jurisdiction.

Kennecott was not doing business in California. Accordingly, California has asserted no jurisdiction over Kennecott. California has not required Kennecott to file a tax return in California nor has California required Kennecott to pay one cent of income or franchise tax to California. Chase, on the other hand, was doing business in California and is concededly subject to the California franchise tax measured by the amount of income attributable to California sources. There is nothing in P.L. 86-272 which purports to prohibit California from using the accounting method which most properly reflects the income attributable to Chase's California activities.

H. THE UNITARY CONCEPT IS VALID IN FRANCHISE TAX CASES AS WELL AS INCOME TAX CASES

Appellant contends that even if Kennecott and its subsidiaries constitute a unitary business, the unitary rule cannot be followed because this is a franchise tax case, not an income tax case. That argument demonstrates the lengths to which appellant feels it necessary to go in order to find an argument to support its position.

It is ridiculous to contend that the combined unitary method is valid in income tax cases but invalid *per se* in franchise tax cases. The issue would be the same in either case, namely, Has California used a reasonable method to compute the amount of income attributable to California sources? If the combined unitary method is a proper accounting technique to determine the amount of income attributable to California sources for income tax purposes, it most certainly would be a proper accounting technique for franchise tax purposes.

The cases relied upon by appellant are not persuasive. The decisions of this Court cited by appellant, such as *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, do not bear upon the question at all. However, the action by this Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal. 2d 214, 238 p. 2d 569, is significant. In *John Deere* the California Supreme Court upheld the application of the combined unitary concept to a group of 85 affiliated corporations engaged in a unitary business. Of that affiliated unitary group, only one subsidiary did business in California. The tax involved was the California franchise tax, the very same tax which is involved in this case. The taxpayer appealed to this Court. This Court, in a *per curiam* opinion, cited *Butler Bros. v. McColgan, supra,* and dismissed the appeal for want of a substantial federal question. 343 U.S. 939. That action certainly refutes the contention that use of the combined unitary method is invalid *per se* in franchise tax cases.

Appellant relies almost exclusively on the 1926 New York State Court decision in *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68. The validity of that case is commented upon by Altman and Keesling in their book "Allocation of Income in State Taxation" 2nd ed. 1950, at pages 173, 4:

> "The case of Studebaker Corp. v. Gilchrist and a limited number of cases following it are often cited in support of a conclusion contrary to that advocated above. In that case, the parent corporation manufactured automobiles which it sold to subsidiaries at a fixed price, and which were in turn sold by the subsidiaries. One of the subsidiaries, but not the parent, was engaged in business in New York. The subsidiary's books disclosed a loss notwithstanding that the entire business of which its activities formed a part was operated at a profit. The New York Tax Commission disregarded the terms of the transactions between the parent and subsidiary and attributed a portion of the income from the entire business to the state. In an opinion based entirely upon a literal construction of the New York law, the taxpayer's objection to the Commission's action was sustained. There is not one word in the opinion which even remotely suggests that the court had any conception or understanding of the considerations involved in the apportionment of the income of a unitary business. It is believed accordingly that this case and the cases relying upon it should be accorded little if any weight. At best, they stand for the proposition that the Tax Commissioner's power and authority should be strictly construed and must be founded on specific statutory provisions, regardless of how essential they may be to the effective enforcement of a highly intricate tax law applying to thousands of taxpayers in a wide variety of businesses conducted in a host of different ways. If this view should be followed generally, it would serve as a serious barrier to effective tax administration."

Appellant's argument is based on the premise that we have taxed Kennecott's income. That is not true. We taxed only the amount of income attributable to Chase's activities in California.

Butler Bros. v. McColgan, supra, dealt with a corporation which operated seven wholesale outlets, only one of which was in California. Constitutionally, California could tax only the income attributable to the California outlet. California had no power to tax any of the income of the six outlets that were outside California. In upholding the use of formula apportionment in the *Butler Bros.* case, this Court was not holding that California could tax the income of the out-of-state outlets. To the contrary, this Court was holding that the formula more accurately determined the income attributable to the California outlet than did the separate accounting records advanced by the taxpayer. Likewise, in this case application of the apportionment formula to the entire unitary business does not result in taxing Kennecott's income, or Chase's income from its activities outside California. Rather, the formula just tells us the true amount of income attributable to Chase's activities in California.

IV. The Arguments of Amici Curiae N.A.M. and C.O.S.T. Are Factually Erroneous and Legally Untenable

We answer herein the arguments contained in the *amici curiae* brief filed jointly by the National Association of Manufacturers and the Committee on State Taxation of the Council of State Chambers of Commerce.

The statements made in the brief filed by these *amici curiae* show that they do not have the slightest understanding of the unitary concept upheld by the California Court of Appeal in this case. For example, the brief states, at page 7, that the four corporations here involved

were treated as a unit ". . . on the sole ground that Kennecott owns controlling stock interest in Chase and the other Kennecott companies." That incredibly inaccurate statement causes one to wonder if *amici curiae* even bothered to read the decision of the California Court of Appeal which they are asking this Court to review.

The four corporations were not held to constitute a unitary business solely because there was unity of ownership. If that were the sole reason, the opinion would have been less than a page long since unity of ownership is conceded. To the contrary, the four corporations were considered as a unit because there existed between the corporations the necessary degree of contribution, dependence and intercorporate dealings to support the conclusion that the corporations were not engaged in truly separate, independent businesses. Moreover, the California Court of Appeal specifically held that two other wholly-owned subsidiaries of Kennecott (namely, Bear Creek and Braden) were not part of the unitary operation. *Amici curiae's* statement that the Court of Appeal upheld the combined unitary method solely because Kennecott owned Chase is an inexcusable misstatement of the holding of the case.[10]

Amici curiae state, page 8, that the decision in this case results in a "burden upon national commerce" which is "compounded by the often discriminatory taxation of multi-

---

10. Although California does not base combining on ownership alone, it is noteworthy that such a rule is not without support. After months of testimony and investigation, the Willis Subcommittee filed its report in which it recommended that Congress adopt a statute which would allow combining upon the basis of ownership alone. Willis Subcommittee Report, vol. 4, pp. 1154-5. See, also, Keesling and Warren, "California's Uniform Division of Income for Tax Purposes Act," 15 U.C.L.A. Law Rev. 156, at 172, wherein the authors conclude that "A broader conception of unity is needed to keep pace with the increasingly complex commercial, industrial and financial world."

state enterprises." The statement is based on the fact that two Utah appellate court cases indicate that for Utah income tax purposes Kennecott must compute the income attributable to its Utah mine by the separate accounting method. Our answer is twofold.

First, as noted previously, there is no constitutional rule which requires that all the individual states follow the identical method in computing income for state tax purposes. In our federal system, the individual states are allowed to determine which system of state taxation best fits the economic and business climate of their particular state. Thus, the issue on this appeal is whether the instant tax on Chase was computed in a constitutional manner. The issue is not whether Utah and California are the same.[11]

But even assuming, for sake of argument only, that there were a constitutional principle that required California and Utah to use the same method, this does not mean that the California approach is wrong. It could just as easily mean that the Utah appellate court was wrong. In that regard, we have serious doubts as to the validity of the Utah decisions. As demonstrated throughout this motion, the unitary concept followed by California is based on sound theory and recognizes that substance, not form, should control. On the other hand, the Utah decisions, which were never appealed to this Court, appear directly contrary to the decision of this Court in *Butler Bros. v. McColgan, supra.*[12]

---

11. There is no basis for raising the spectre of double taxation in this case. There is nothing in the record which in any way indicates that Kennecott and its subsidiaries paid tax on more than 100% of their combined income.

12. Apparently Kennecott is about to contest the validity of the Utah decisions. The *Salt Lake Tribune*, May 29, 1970, page 38, reveals that Kennecott and its affiliates began filing on a consolidated in Utah in 1967 and that it is protesting the deficiencies assessed by the Utah State Tax Commission.

Amici curiae infer that they speak for the business community generally throughout the United States. It is readily apparent, however, that their interest here is really on behalf of the extremely large multistate business—the only business which, as a practical matter, could take advantage of the income computation rules for which appellant seeks approval in this case. Acceptance of appellant's arguments that combination is unconstitutional *per se* would actually work to the detriment of the thousands of small intrastate businesses, since undoubtedly they would have to bear the burden, through increased tax rates, of the benefit given to the relatively few large interstate businesses. Take the retail grocery business, for example. If this Court accepted appellant's argument that use of the combined unitary method is *per se* invalid, there are a few large interstate grocery companies, such as A & P and Safeway, that could arrange their affairs so as to take advantage of the decision and lower their tax. The literally hundreds of small companies which operate only a single store or a chain of stores within a single state would receive no benefit at all.

V. The Arguments of Amicus Curiae F.E.I. Are Completely Untenable

Amicus Curiae Financial Executives Institute, Inc., states that the present decision is "blatantly discriminatory against multi-corporate enterprises." That is absurd. It is not discriminatory to look to substance rather than form so that all interstate enterprises are taxed equally.

A multistate business could extend its operations into California in either of two ways. One way would be to open a branch here. That would have been the situation had Kennecott elected to have its fabricating operations conducted by divisions of Kennecott itself. If that form had been followed, *amicus curiae* would apparently agree that the income attributable to Califoria should be computed by

applying an apportionment formula to Kennecott's entire unitary income. However, Kennecott followed the other route, i.e. it maintained its fabricating operations in the form of wholly-owned subsidiaries. Under the California approach, that fact does not change tax consequences as, indeed, it should not.

Objectively considered, the combined unitary method really does no more than remove one of the tax avoidance tools from the large stock of tax planning devices used by the tax departments of the giant multistate enterprises. To tax all multistate businesses the same, regardless of whether conducted in unicorporate or multicorporate form, is not discriminatory—it is fair, just, and reasonable.

Amicus curiae states that the present decision removes "the most fundamental safeguard against multiple taxation," citing the fact that Kennecott Wire paid Rhode Island a tax on its entire income computed by the separate accounting method. In the first place, there has been no showing that the Rhode Island tax would be lower if computed pursuant to the combined unitary method. In fact, a reliable estimate would be just to the contrary.

But even if the unitary approach would produce a lower tax in Rhode Island, that does not mean that the unitary approach is wrong and cannot be followed by California. It just means that there is a difference between California and Rhode Island in the method of accounting used to compute net income from sources within the jurisdiction. We have demonstrated that application of the unitary approach in this case is reasonable and correct. Accordingly, Kennecott Wire should have reported on the unitary basis in Rhode Island.[13] If all states followed the unitary

13. There is no evidence to indicate that Kennecott Wire attempted to file on a unitary basis in Rhode Island and we cannot speculate as to what the results would have been had it proceeded on that basis.

concept endorsed by this court in *Butler Bros. v. McColgan, supra,* and *John Deere Plow Co. v. Franchise Tax Bd., supra,* there would be none of the multiple taxation imagined by *amicus curiae.*[14]

Lastly, *amicus curiae* voices the fear that the unitary concept might be applied to businesses operated outside the continental United States. Our response to that contention is limited since the question of inclusion of foreign operations in the unitary business is not involved in this appeal.

Bass, Ratcliff & Gretten, Limited v. State Tax Commission, 266 U.S. 271, dealt with a British corporation engaged in brewing and selling Bass's ale. All its brewing was done and a large part of its sales were made in England; but it imported a portion of its product into the United States which it sold through branch offices located in New York City and in Chicago. The company had no net income upon which it was subject to federal income tax. It did, however, have an overall net income of $2,185,600. New York allocated a portion of that total net income to New York by use of an apportionment formula and applied its franchise tax accordingly. The taxpayer protested and this Court upheld the tax as assessed. In so holding, this Court recognized the principle that formula apportionment is a valid way to determine the amount of unitary income attributable to business activity within a state, regardless of whether the portion of the business done outside the state is done in another state or in a foreign country.

---

14. The fact that to our knowledge no case of actual multiple taxation has been brought to the courts in the decades of state income taxation strongly suggests that the problem exists more in the imagination of *amicus curiae* than in actual real life.

VI. The Arguments of Amicus Curiae T.E.I. Are Addressed to the Wrong Forum

Amicus curiae Tax Executives Institute, Inc., states that there is a degree of "uncertainty" in the law because a taxpayer cannot always determine in advance whether a particular state will require use of the combined unitary method. *Amicus curiae* cites the statement to that effect found in the Willis Subcommittee Report. Undoubtedly the observation of the Willis Subcommittee has some merit. A certain amount of diversity is bound to occur in a federal system whereby the states are allowed to develop, within constitutional limits, their own tax policies.

Appellant and *amici curiae* appear to advocate resolving the "uncertainty" problem by adopting a rule to the effect that the combined unitary method cannot be used at all. That is tantamount to killing the patient to cure the cold. The Willis Subcommittee Report itself recognizes that the combined method is a proper accounting technique that must be maintained for proper administration of state tax laws. The subcommittee resolved the "uncertainty" problem, not by banning the combined method, but by allowing its use in all cases where the ownership relationship existed. Willis Subcommittee Report, Vol. 4, pp. 1154-5. That recommendation was embodied in H.R. 11,798 (Willis), which was the result of the Subcommittee's work. Strangely enough, neither appellant nor any of the four *amici curiae* herein supported the bill. In fact, three of *amici curiae* appeared and openly opposed the bill. These actions on behalf of those that represent big business interests speak louder than their words and indicate that they are not really interested in "certainty" at all—surely H.R. 11,798 would have provided that. What they really seek is a rule that prohibits use of the combined method altogether, with the

result that the states must tax on the basis of form rather than substance.

The complaints of *amicus curiae* regarding the problem of compliance with the various state laws are more properly addressed to Congress, since the solutions they seek are legislative in nature, not judicial. There is no constitutional principle which requires the states to compute net income in precisely the same manner or to use the same apportionment formula. If there should come a time when the diversity reaches the point that it is a significant burden on national commerce, the Congress may decide to set down uniform income computation and apportionment rules to be followed by the states.

In that regard, it is appropriate to note that there may well be congressional action in this area in the near future. H.R. 7906 (Rodino), titled the Interstate Taxation Act, has passed the House of Representatives and is now awaiting hearing by the Senate Finance Committee. That bill provides for a uniform apportionment formula to be used by all the states. A probably more significant bill is S.2804 (Magnuson), which gives congressional consent to the Multistate Tax Compact. The Compact already has twenty regular state members and thirteen associate state members, of which California is one. The Compact creates the Multistate Tax Commission, an agency aimed at resolving the areas of diversity about which the business sector is complaining. The Multistate Tax Commission has gained considerable support. At its recent annual meeting, the National Governor's Conference gave its unqualified support to the Commission. Last August, the American Bar Association voted to support the Multistate Tax Concept consent bill. The Commission is currently drafting a pro-

posal which would provide for uniformity in those areas where uniformity is most needed.

The problem areas in the allocation and apportionment of income arising from multistate, multicorporate enterprises are extremely complex. They involve the study of economic theory and the realities of business life and compliance costs. It is readily apparent that the answers lie in the legislative area, not with the courts. Noting probable jurisdiction in this case will not lend "certainty" to the law. Even if this Court reversed the decision of the California Court of Appeal and held that combining was not proper in this case, it would leave to future litigation the determination of whether combining was proper in other cases. On the other hand, dismissing this appeal will make one thing "certain," namely, California will continue to use the combined apportionment method to compute the income attributable to California sources whenever a unitary business is conducted in multicorporate form.

CONCLUSION

For the reasons set forth above, it is submitted that this Court should dismiss this appeal or, in the alternative, affirm the decision of the California Court of Appeal.

Respectfully submitted,

THOMAS C. LYNCH
Attorney General

JAMES E. SABINE
Assistant Attorney General

JOHN J. KLEE, JR.
Deputy Attorney General

Attorneys for Appellee

LIBRARY
SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
DEC 2 1970
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Brief of Appellant in Opposition To Motion To Dismiss Or Affirm

VALENTINE BROOKES
601 California Street
1600 International Building
San Francisco, California 94108
Attorney for Appellant

SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

SUBJECT INDEX

	Page
A. The Facts	2
B. The Legal Contentions	8
C. Public Law 86-272	16
D. The Amicus Briefs	17
Conclusion	20
Appendix	

TABLE OF AUTHORITIES CITED

Cases	Pages
Butler Bros. v. McColgan, 315 U.S. 501	8
John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214, 238 P.2d 569	8, 9
Edison California Stores v. McColgan, 30 Cal.2d 472, 183 P.2d 16	16
General Motors Corp. v. District of Columbia, 380 U.S. 553	12
Norfolk & Western Ry. Co. v. Missouri Tax Comm., 390 U.S. 317	7, 10, 11, 12, 20
Kennecott Copper Co. v. State Tax Comm., 118 Utah 140, 221 P.2d 857 (1950)	18
Kennecott Copper Corp. v. State Tax Comm., 5 Utah 2d 306, 301 P.2d 562 (1956)	18
Pacific Company v. Johnson, 285 U.S. 480	14
Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602	14

Statute	
15 U.S.C. § 382 (P.L. 86-272)	8, 17, 21

Other Authorities	
H.Rep. No. 1480, Vol. I, p. 115, 88th Cong., 2d Sess. (1964)	11
Lewis Carroll, Through the Looking-Glass, ch. 5	9
Year Book of the American Bureau of Metal Statistics	7

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Brief of Appellant in Opposition To Motion To Dismiss Or Affirm

Appellee's Motion to Dismiss or Affirm is without merit and should be denied. Probable jurisdiction should be noted, since the case presents substantial federal questions.

Appellee's motion creates a false impression of the content of the record in this case, and hence of the basis on which the California courts decided the case. It is necessary that we reply to correct that false impression about the facts in the case, because constitutional rights exist in relation to facts, not *in vacuo*. We will also reply to appellee's legal arguments where we consider reply warranted.

A. THE FACTS.

1. The Federal Trade Commission report and the economic essay relied upon by appellee (Motion, pp. 20-23) were not in the record in the State courts. While the California courts could take judicial notice of them, they were not evidence in the case. Accordingly, when the Court of Appeal stated that the evidence was uncontradicted, it was referring to that placed in evidence by the parties and not to opinions of non-witnesses. That evidence included the testimony of witness Carl Lentz, President of Kennecott Sales Corporation. Mr. Lentz testified that during most of the three years herein involved (1954-1956, inclusive) the demand for copper exceeded the supply (R.T. 96-97) so that Kennecott Sales Corporation was compelled to place its customers on allocation (R.T. 97), and that Chase was subject to the same allocation that other customers were. (R.T. 96; also Stip. 21, Juris. Statement, App. p. 44.) This allocation, he testified, was based upon the record of purchases of the particular customer in the past, in which Chase was treated exactly as were other customers. He also testified that Chase bought on the same terms and at the same price as other customers, and that the same applied to Chase's competitors. (R.T. 99; Stip. 21, Juris. Statement, App. p. 44.) Finally, he testified that the producer's price charged by Kennecott, Phelps Dodge and Anaconda was ordinarily less than the price on the London Metal Exchange, which the smaller producers and the custom smelters such as American Smelting and Refining Company charged their customers. He testified that when Chase and others had to supplement their supply from those sources they had to pay a higher price than when they purchased from Kennecott. (R.T. 115-116; see also Stip. Findings, Juris. Statement, App. p. 17.)

The Federal Trade Commission study, published in 1947 and involving facts reported to the F.T.C. in 1937, did not involve the years 1954, 1955 and 1956, and if it did would be contrary to the evidence in the record, summarized above. Since the Court of Appeal called the evidence uncontradicted, it had to be referring to Mr. Lentz's testimony and the stipulation of facts. Hence there could have been no possible basis for the Court of Appeal disapproving the finding of the trial court that:

> "Chase's income and expenses all arise as a result of arm's length dealing at market prices. * * * The only substantial business contact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent marketplace.
>
> "Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, * * *." (Juris Statement, App. p. 20.)

The same comment applies to the citation by appellee of the Yale University economic essay.

Appellee suggests that we do a "disservice" to both the Board and the Court of Appeal by supposing that either of them relied on the facts in the record instead of on these economic studies dealing, apparently, with other periods when the facts must have been different. We do not know what the Board relied on, but we do know what the Court of Appeal relied on: it relied on the evidence in the case, and the only evidence it could find containing what it thought were unitary characteristics was that which it analyzed in its opinion. Appellee (Motion, p. 24.) seems to join us in feeling that the supposed unitary incidents relied

on by the Court of Appeal are minor and would not justify the Board in having acted as it did. Indeed, appellee calls them "supplemental" and says that they are not "the touchstone of the Board's determination." The Board did not, however, place these studies in evidence, and had it done so they might not even have been received, since they did not relate to the years before the court. Mr. Lentz's testimony did, however, and it was acknowledged by the Court of Appeal to be uncontradicted.

The quotation of a statement made in 1958 by a vice president of Kennecott is in a different posture, because it is in the record through an exhibit in the trial court. That extract is from a recommendation made by that executive that Kennecott should buy the stock of Okonite, for the benefit the acquisition would be "to the *future* marketing of Kennecott's refined copper." The balance of that gentleman's recommendation shows that Kennecott anticipated enlarging its productive capacity (as does Stip. Exh. G), and was concerned with the future. The future as seen in 1958 does not include the years 1954, 1955 and 1956. We do not understand why appellee believes that we should have pointed this out to the Court, since had the Court of Appeal considered this a relevant fact it would have created a contradiction with Mr. Lentz's testimony, and the Court of Appeal, as appellee itself has pointed out to the court, stated that the evidence was uncontradicted.

Mr. Lentz's testimony contained an additional interesting fact, which was relied on by the trial court for a finding.[1] This was his testimony that on one occasion Chase's sales executives asked Mr. Lentz to use his good offices with some

1. "Neither Kennecott nor Kennecott Sales has ever used its market position to help Chase or Kennecott Wire acquire a customer, although the opportunity to do so has existed." (Juris Statement, App. pp. 19-20.)

customers of Kennecott to persuade them to purchase some of Chase's products from Chase, and Mr. Lentz refused, taking the position that Kennecott Sales could not do favors for Chase which it would not do for any other customers. (R.T. 125-126.) This testimony buttresses the conclusion that the relationship between Chase and Kennecott was governed by the factors of the marketplace and arm's length dealing.

2. Appellee has stated that the Court of Appeal exercised a prerogative under California law to disagree with the findings of fact of the trial court on the ground that they were conclusions of law since the evidence was uncontradicted. If by this appellee means that the Court of Appeal was free to disregard uncontradicted evidence and substitute findings of fact inconsistent with the uncontradicted evidence, it accuses the California court of something we do not. We believe that the California Court of Appeal followed more traditional judicial practices, and concluded that the evidence was conclusive. The evidence we refer to is that which caused the trial court to find that:

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden, and Kennecott Sales * * *
>
> "Chase's business activities are not so interrelated with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected in each's separate books of account * * *
>
> "Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership." (Juris. Statement, App. p. 20.)

Those findings of fact are indeed findings of fact, and are not legal conclusions. They are supported by evidence in the record which the Court of Appeal regarded as uncontradicted. What the Court of Appeal did, contrary to appellee, was to treat those findings of fact as irrelevant to what it considered to be the ultimate issue in the case, which was whether or not Chase was unitary with Kennecott. There was also a finding that there was "no need to resort to an artificial redetermination by formula of the incomes of each corporation." (Juris. Statement, App. p. 20.) This was the finding the Court of Appeal said was to be treated as a conclusion of law.

We do not regard the question whether Chase was unitary with Kennecott as the ultimate issue in the case, since the evidence shows that to treat them as unitary by the use of a combined allocation formula is to distort Chase's income by allocating some of Kennecott's income to it, which the record shows is income which it could not possibly have earned itself. The income came from Kennecott's great mines in Utah and elsewhere, none of which are in California. California has no jurisdiction to tax Kennecott's income.

3. Appellee refers to the stipulation that in 1955 Kennecott appointed an assistant to the president to be of assistance to the subsidiaries as if that were a stipulation that in the years in question he actually contributed to the operations of Chase.[2] We did not mention it before because the Court of Appeal did not do so, and did not rely on it. It could not well have done so, because the stipulation is silent about the contributions of that official to Chase. So

---

2. The exact language of that portion of the stipulation of facts is "In December [1955], Mr. D. Ayers was appointed Assistant to the President to assist the subsidiaries with their engineering problems. Mr. Ayers was formerly Chief Engineer of Wheeling Steel Corporation." (Exh. B, Stip., p. 20.)

far as is disclosed by the stipulation, that official did not visit Chase, did not consult with any Chase executive, or in any way contribute anything to Chase or its operations. That appointment is therefore not evidence that Chase and Kennecott were unitary.

4. Appellee argues that the trial court's finding that Chase did not enjoy special favors from Kennecott is wrong because the allocation system in effect when demand outruns supply favors Chase. This argument is squarely contrary to the findings,[3] and is based entirely on the speculation that the base period used in determining entitlement must have included years when supplies were easy and Chase's competitors bought elsewhere. The use of speculation to overturn findings is strange. The Court of Appeal did not disapprove the finding. Cf. Juris. Statement, App. 10.

Appellee's speculation, even absent the finding, would be the sort this Court declined to permit in *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317. There is a contrary finding, however.

The record contains evidence contrary to appellee's speculations. Plaintiff's Exhibit 3 is the *Year Book of the American Bureau of Metal Statistics*. Page 17 of that Exhibit shows the domestic copper stocks from 1942 to the end of 1956, a period of 15 years. It shows a deficit in copper supplies available to fabricators[4] continuously throughout that period except for the last seven months of 1956, and emphasizes the significance of the deficit by the statement that the available supplies were augmented beginning in 1951 by releases from the government stockpile.

---

3. "In times of copper shortages, Kennecott does not supply its subsidiaries copper more favorably than it supplies its other customers." Juris. Statement, App. p. 20.

4. Chase is a "fabricator."

Hence the prior periods of oversupply which appellee's speculation assumes existed are shown by evidence not to have existed since 1941, and the record is silent whether they existed earlier.

Moreover, appellee's speculation assumes (Motion, p. 27) that the copper from scrap and from custom smelters would be less expensive than the producers price Kennecott Sales charged. Mr. Lentz testified that in times of copper deficit the producers price, which was stable, would be from one cent to twenty-one cents less than the other prices, which were more volatile. (R.T., 115-116.) With an almost continual copper deficit for 15 years, no Kennecott customer could afford to buy from anyone not selling at the producers' price, to the extent of available allocations.

B. THE LEGAL CONTENTIONS.

1. Appellee seems not to know that Public Law 86-272 contains a provision prohibiting the assessment of taxes for prior years, if the assessment should be attempted after the effective date of that public law. (15 U.S.C. Sec. 382.) The Public Law was passed in 1959. The assessments herein were proposed on August 31, 1960 (Exhibits N-1, N-2, N-3). Therefore, they were prohibited by the statute. The text of that provision in the Public Law is set forth in the appendix hereto.

Accordingly, the question whether California can succeed in circumventing the prohibitions of that Public Law is directly presented in this case and should be considered by this court.

2. There are no decisions from this court sustaining what the court below did, and appellee has cited none. It relied primarily on *Butler Bros. v. McColgan,* 315 U.S. 501, and the dismissal by this Court (343 U.S. 939) of the appeal from the decision by the California Supreme Court in *John*

Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214, 238 P.2d 569. The issue raised here was not raised in either case. *Butler Bros.* involved a single corporation and a question of geographical allocation of the income of that corporation. The issue raised in the *John Deere* case was the same, and no issue about the propriety of consolidating several corporations was raised.[5]

3. Appellee's argument is basically that it has not taxed the income of Kennecott or the other corporations. In form what appellee says is true, because it has assessed the tax on their income against Chase. In substance, of course, it is not. If, as the trial court found and the evidence shows, Chase could not possibly have earned the income assigned to it by the Board, and that income is attributable, as found by the trial court, to the Kennecott operations, it follows that what California is doing is taxing Chase measured by Kennecott's income. We find it impossible to comprehend appellee's insistence that this obvious truth does not exist. Again we find the most appropriate metaphor in fantasy:

> "Alice laughed. 'There's no use trying,' she said: 'one *ca'n't* believe impossible things.'
>
> " 'I dare say you haven't had much practice,' said the Queen. 'When I was your age, I always did it for half-an-hour a day. Why, sometimes I've believed as many as six impossible things before breakfast.' " Lewis Carroll, *Through the Looking-Glass,* ch. 5.

4. The only corporation in the group which the Court of Appeal held unitary which does business in California is Chase. Therefore, California's jurisdiction is dependent on

---

5. Appellee has seen fit to mention that appellant's counsel was attorney for the taxpayer in the *John Deere* case, and to attempt to make capital of the fact. Personal references of that type are regrettable. Since it has been made, counsel should also reveal that he was counsel for the state in the *Butler Brothers* case. If any implication flows from these facts, it may be that he is familiar with the facts, arguments and decisions in those cases.

its jurisdiction over Chase. For this reason, it does not matter whether or not Kennecott is unitary with Kennecott Sales, or with Kennecott Wire. For this reason we did not discuss those relationships in our Jurisdictional Statement. Only if the relationship between Chase and Kennecott is unitary has California any jurisdiction over Kennecott so that the question of Kennecott's relationship to its other subsidiaries can arise. However, the question whether Chase and Kennecott are unitary is merely the threshold question in the case, since even if they are, the consolidated formula cannot be applied if the effect is to distort. This was made abundantly clear, we believe, by this court's decision involving an obviously unitary business in *Norfolk & Western Railway* v. *Missouri Tax Comm.*, 390 U.S. 317.

Appellee's statement of its position in its summary of argument (Motion, p. 7) is a succinct statement of its erroneous thinking. Appellee there says that "[i]n this case the Court of Appeal held that the four corporations were unitary and that, therefore, *a* formula should be used." This is supposed to be a distinction of the *Norfolk & Western* case. However, in the *Norfolk & Western* case a single corporation was engaged in a unitary business, and one which is the original, classic example of a unitary business. If that circumstance were sufficient to justify the use of a formula, then the formula in the *Norfolk & Western* case should have been sustained. This court did not sustain it. It held the statutory formula unconstitutional. That is what we ask be done here. The evidence in the *Norfolk & Western* case showed that the formula produced a distorting result and the evidence here does the same thing. The Court of Appeal declined to consider the evidence of the distorting effect, and concluded that it was sufficient to justify the use of the formula that the businesses be unitary.

While we deny that they are unitary, that is still merely the threshold question, not the ultimate question. The ultimate question, as this court held in the *Norfolk & Western* case, is whether the formula seriously distorts. Since it multiplies Chase's corporate net income sevenfold, it distorts in a serious measure.

Appellee further attempts to distinguish the *Norfolk & Western* case by claiming that it is not relying on any unitary enhancement theory to justify its consolidated formula (Motion, pp. 38-40). It appears to us that appellee has mesmerized itself into a state of unthinking acceptance of its own righteousness. It has clearly lost sight of the historical justification for the use of apportionment formulae in unitary businesses.

Appellee's argument shows that the historical support for apportionment formulae is challenged by California, and that California asserts the right to use its formula regardless of the absence of unitary enhancement, regardless of the distortions it produces, merely because of common ownership, and of minor incidents of common operation such as must normally flow from common ownership.

It is apparent that appellee's analysis of its own defense presents a substantial federal question.

5. Again here, as it did below, appellee calls any evidence relevant to the case "separate accounting." Separate accounting is not a phrase found in the Constitution, but it has been used by this Court and other courts, and when used by this Court it has been used to describe one process for making a geographical division of the income of a single corporation; i.e., it is an effort to determine how much of the net income of a *single* corporation is derived from a particular taxing state. See H.Rep. No. 1480, Vol. I, p. 115, 88th Cong., 2d Sess. (1964). To apply that concept,

with the recognition of its inadequacies, to the well seasoned techniques for determining the net income of a corporation, from its overall operations in all geographical locations in which it operates, is a confusing tactic. The figures used to determine corporate net income are not suspect; they are derived from the same source as those used in the formula, i.e., the taxpayer's books. Even the net incomes are the same, except that in one instance they are first scrambled and then unscrambled, and in the other they are as shown by the books. None of that is true of geographical allocation by separate accounting.

However, if "separate accounting" means to the Court what it means to appellee, then the evidence which this Court held overturned the Missouri statutory formula in *Norfolk & Western Ry. v. Missouri Tax Comm.*, 390 U.S. 317, was separate accounting.

6. Appellee misuses this court's decision in *General Motors Corp. v. District of Columbia*, 380 U.S. 553. This court did not decide that the business of General Motors was unitary, because the parties conceded that it was. Had that fact been in issue, however, this court would have learned from the evidence that there is much more than "centralized departments which handle such matters as accounting and insurance which tie together otherwise operationally independent divisions" (Motion, pp. 17-18). The Court would have learned that what appellee terms "operationally independent divisons" use interchangeable bodies, sparkplugs, brakes, transmissions, power steering, air conditioning and batteries, as well as chassis purchased from the same outside source. For instance, a Chevrolet Impala uses the same body shell as a Buick Le Sabre and a Pontiac Catalina, and Cadillac uses the same body shell as the Buick Electra and the Oldsmobile 98. The record

would have shown that all makes of General Motors cars obtain their power steering from the Saginaw division of General Motors, all use sparkplugs from its A-C division, and all obtain their batteries from its Delco division. The record also would have shown that they all purchase their brakes from Bendix, and their chassis from Dana, both outside suppliers. Since appellee characterizes this relationship as "operationally independent divisions," we are at a loss to understand why it regards our operationally independent corporations as unitary.

7. Appellee (Motion, p. 5) compares the relationship between Chase and Kennecott to that of the fabricating subsidiaries of Anaconda and Phelps Dodge with their respective parents. The record is meager about the relationship between those major producers and their manufacturing subsidiaries. It is replete, however, with evidence about the relationship between Chase and Kennecott. We do not think that appellee is justified in stating that "appellant virtually admitted that Phelps Dodge and its fabricating subsidiary were unitary." We do not represent Phelps Dodge, and do not know what the facts concerning Phelps Dodge and its fabricating subsidiary are. We have neither the knowledge on which to make an admission, nor the legal responsibility to make any admission meaningful. Appellee is therefore unjustified in attempting to make an argument that Chase and Kennecott should be consolidated because someone thinks that Phelps Dodge and its fabricating subsidiary also should be. Presumably that is appellee's position, but even that is not shown by the record.

8. As we pointed out, appellee displays a strangely inconsistent attitude toward the sanctity of the corporate entity, according to the consequences which it wishes to flow from its position. Where it can sustain a tax by dis-

regarding the corporate entity it does so, even though it is imposing a franchise tax. Where, as in *Pacific Company v. Johnson*, 285 U.S. 480, it can sustain a tax by arguing for the sanctity of the corporate entity, it does that. Yet, with all deference, we suggest that the Board cannot have it both ways. If this is a franchise tax which it is administering, then the income by which the tax is measured should be that earned by the taxed franchise. That earned by a franchise beyond the jurisdiction of the state to tax should not be taxable by it. Thus Chase's tax should be measured by its own net income, and since Kennecott cannot be taxed its income should not be assigned to Chase as a measure of the success of Chase's franchise.

Appellee discusses this case as if the sole, ultimate beneficial owner of all these corporations is Kennecott. But if the corporate entity is to be disregarded, why stop there? The ultimate beneficial ownership is not in Kennecott but in Kennecott's shareholders. Thousands of them must be individuals, since the stock is listed on the New York Stock Exchange and traded freely. Why should appellee have the right to impose a franchise tax imposable only on corporations if it disregards the entity of corporations? Why should it not be compelled to make its choice between taxing Kennecott's shareholders as if there were no corporations at all, or taxing the corporations on the values in their franchises? This question presents a substantial federal question, in view of the settled fact that taxes on corporate franchises have a recognized constitutional status in which states enjoy advantages from recognition of that status, but also must accept limitations. See *Spector Motor Service, Inc., v. O'Connor*, 340 U.S. 602, for one of the limitations. Another limitation, where a state elects to tax franchises, is that only the property and income owned by that corpo-

ration which is being taxed can be used to measure the tax on its franchise. This substantial federal question is presented when a state seeks to recognize a franchise for the purposes of taxing it, but simultaneously to ignore it when seeking to determine the measure of the tax.

This case does not present the question presented by appellee's straw man, whether the incomes of several corporations may be combined into a consolidated whole and then reallocated where each corporation in the group is merely an incorporated function in an indivisible business. Thus if Kennecott separately incorporated its mines, its smelters and its refineries, without all of which it could not produce a marketable product, the question argued by appellee would be presented and not be a straw man. That question is not present here, since Kennecott is a viable, integrated business, and so is Chase. The exception to what we have said about Kennecott lies not in its relationship with Chase but in its reliance on American Smelting for some essential functions, so that if Kennecott is unitary with any corporation it is unitary with American Smelting and Refining Company. Yet appellee has not sought to combine them, and recognizes that it cannot do so, because of their separate ownership. This reduces appellee's professed concern with unitary operation to a concentrated interest only in unity of ownership.

9. Appellee has not truly sought to support the decision of the Court of Appeal on the basis on which that court itself supported it. Appellee apparently recognizes the truth of our contention that the minor incidents consequent upon common ownership on which the Court of Appeal relied prove nothing more than common ownership and do not prove unity of operation. Thus, appellee's motion is based upon fictitious facts and not those present here,

and is not at all based on support of the decision below on the record on which it was made.

Yet it would remain true, even if the court below were correct that there were sufficient incidents of unity to justify a conclusion that the two corporations would ordinarily be unitary, that the use of a combined formula distorts the income allocable by that process to California, producing an unconstitutional result.

10. Appellee makes too much of the old California case of *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16. The opinion there is permeated with indications the court was disregarding the corporate entity of the subsidiary, and on the facts it should have done so. Everything was done at the parent's office but sell the product at retail. The subsidiary had no right to order shoes to replenish inventory, and did not even have its own set of books. 30 Cal. 2d at 474, 183 P.2d at 18.

The Chase case is not one for the disregard of the corporate entity; the Court of Appeal did not do so, appellee has never so argued, and it made the assessment against Chase, not Kennecott. Appellee has even stipulated that Kennecott does not do business in California. (Stip. par. 3; Juris. Statement, App. p. 29.)

C. PUBLIC LAW 86-272.

We have shown in our first legal argument above that this federal statute prohibits assessments of tax after its enactment even for earlier years, and that these assessments were first proposed a year after that enactment.

Appellee also defends the practice it employed here on the ground that it was first adopted before 1959 and accordingly

not to circumvent P. L. 86-272. What this argument overlooks is that Congress intended to outlaw existing, demonstrated state practices which this Court had recently upheld in two cases. California was not excepted from the prohibition. If it has failed to heed the prohibition, its right to do so is a federal question, and since its position would operate to circumvent a clear Congressional prohibition, the federal question is substantial under the Commerce Clause.

D. THE AMICUS BRIEFS.

The briefs of the four amici curiae show that our contention that the case is of great importance is not merely the hopeful assertion of partisan advocacy. The same is true of their support for our contention that the federal questions presented are substantial.

From the intemperate emphasis in appellee's reply to those briefs, it would appear that appellee is of the same mind.

It is not our province to defend the briefs of the amici, but we believe reply to arguments appellee has made which may influence the Court's ruling is incumbent on us.

1. Appellee has attacked one of the amicus briefs for asserting that common ownership is enough to satisfy California's concepts of unity. The facts in this case show that Kennecott's operations were much more integrated with those of American Smelting than with Chase. Yet no effort has been made to consolidate Kennecott with American Smelting. The reason is that Kennecott owns no stock in American Smelting. Because Kennecott owns the stock of Chase, certain minor common conduct of a type that is an invariable corollary of common ownership

is said by appellee and the Court of Appeal to make the two unitary. It appears to us that the amicus is right. All that appellee really looks for seems to be common ownership, and once that is found appellee leaps onto every minor incident of common ownership, even where it lacks economic significance.

Appellee points out correctly that the Court of Appeal excluded Braden Copper Co. and Bear Creek Mining Co., both of which were wholly owned. Braden operated exclusively in Chile, under radically different economic conditions. We have been informed by responsible state officials that the Franchise Tax Board does not intend to apply the Braden decision to other cases because of the brevity of the opinion, but presumably the California courts will react differently. We can then qualify the California rule where common ownership exists by adding that California will hold the corporations unitary if both operate in the United States. Bear Creek explored in California but found no deposits so we can add that the California rule also requires that the subsidiary add either gross income or property of value to the unit as a condition to unitary status. With those minor qualifications, the amicus seems to be correct.

2. Appellee responds to the citation by one amicus of the Utah cases involving Kennecott[6] by a footnote reference (Motion, p. 46) to an account in the Salt Lake Tribune. Kennecott filed its Utah returns after 1966 in conformance with a 1966 amendment to the Utah tax statute as Kennecott interpreted it. As the newspaper account also states, the Utah Tax Commission challenged Kennecott's interpreta-

---

6. *Kennecott Copper Co. v. State Tax Comm.*, 118 Utah 140, 221 P.2d 857 (1950). *Kennecott Copper Corp. v. State Tax Comm.*, 5 Utah 2d 306, 301 P.2d 562 (1956).

tion. A hearing before that body was recently held and the issues are still pending before it. Because the Utah statute differs materially from the California statute the issue herein is not presented there.

3. In seeking to disparage the status of the *amici curiae* as spokesmen for American business, appellee asserts (Motion, p. 47) that they speak only for big business, and that, they seek to shift the tax burden from big business to small business. Appellee appears to be appealing to what it must believe to be biases of the members of the Court.

If such an argument has any impact, it is an invitation to dispose of the case on the basis of prejudices borne of general biases and not on precedents and principles derived from the Constitution.

If the Court wishes a reasoned answer to that suggestion, it lies in the fact that as once passed by the House of Representatives the Willis-Rodino Bill limited its scope to multi-state businesses earning net income of $1,000,000 or less. The House evidently thought small business needed protection from state tax administrators. It would appear that it also thought that big business could be left to the protection afforded by this Court.

4. The suggestion (Motion, pp. 50-52) that Congress may soon legislate does not fully inform the Court. Public Law 86-272 provides supposedly temporary rules pending further Congressional study. That study has produced volumes of hearings and reports but not a single statute. The current Congress will end without disturbing that status.

As noted above, the one bill which passed one house of Congress exempted businesses with net incomes exceeding $1,000,000 from its scope. It would not, therefore, have pre-empted the field.

Moreover, that bill did not expressly deal with the right of the states to consolidate the net incomes of groups of affiliated corporations.

If the amici did not all support a bill with such significant omissions, they may have wanted one which would do more to provide certainty. That would be a rational hope.

Many of the states oppose federal legislation in the field. We wish appellee had told the Court what California's position is. It has sent witnesses to testify on these successive bills at least once when the testimony, as reported, was in opposition.

The Multistate Tax Compact has not been approved by the Congress which is about to end. It does not have unanimous support from the states. Of the 33 state adherents, 13 are associate members because of various reservations.

The apparent suggestion of appellee that this Court can surrender the field to Congress is unfounded. Substantial federal questions will continue to arise in it under any legislation which has had a Congressional sponsor, particularly in the field of consolidation of affiliated groups, where the committee bills and Senate sponsored bills are mute.

CONCLUSION

The Motion to Dismiss or Affirm is not only unsound but actively demonstrates how badly this field of law is in need of enlightenment from this Court. California shows by the arguments it makes in support of its motion that the administration of its law is proceeding without support from any decisions of this Court, and contrary to principles recently restated in *Norfolk & Western v. Missouri Tax Commission,* 390 U.S. 317. There are substantial federal questions presented, both under prior decisions of this

Court, under areas untouched by decisions of this Court, and concerning the effectiveness of the Congressional enactment Public Law 86-272. Probable jurisdiction should, accordingly, be noted.

San Francisco, California, December 1, 1970.

Respectfully submitted,

VALENTINE BROOKES
Attorney for Appellant

Appendix

15 U.S.C. § 382

Assessment of net income taxes; limitations; collection

(a) No State, or political subdivision thereof, shall have power to assess, after September 14, 1959, any net income tax which was imposed by such State or political subdivision, as the case may be, for any taxable year ending on or before such date, on the income derived within such State by any person from interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 381 of this title.

(b) The provisions of subsection (a) of this section shall not be construed—

> **(1) to invalidate the collection, on or before September 14, 1959, of any net income tax imposed for a taxable year ending on or before such date, or**
>
> **(2) to prohibit the collection, after September 14, 1959, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.**

15 U.S.C. § 383

Definition

For purposes of this chapter, the term "net income tax" means any tax imposed on, or measured by, net income.

Pub.L. 86-272, Title I, § 102, Sept. 14, 1959, 73 Stat. 556